The Q3 2014 Preqin Quarterly Update

Infrastructure

Insight on the quarter from the leading provider of alternative assets data

Content includes...

Fundraising
Positive quarter for unlisted infrastructure fundraising.

Funds in Market
Record number of funds seeking capital.

Investors in Infrastructure
Future investment plans for infrastructure investors.

Deals
Infrastructure deal flow remains strong.

AUM and Dry Powder
Uncalled capital reaches record high.

Fund Performance
The latest performance figures.

Plus, Special Guest Contributor: Capstone Partners
Foreword

Fundraising for private infrastructure funds has remained strong in 2014 to date, with the 14 funds closing on an aggregate $8.5bn in Q3 2014 bringing the total raised throughout the year to $27bn, a small increase on the $23bn raised over the same period last year. However, capital is further concentrated among a smaller selection of managers, with the number of funds to close falling. Just 28 funds have closed in the first three quarters of this year, compared to 41 in the same period in 2013.

Competition for investor capital remains high; a record 148 funds are currently on the road targeting $95bn, with 61% of these managers having already been on the road for over a year. However, institutional investor appetite has increased, with 57% of investors planning to commit more capital to the asset class in the next 12 months than they did over the previous year, and 42% intending to increase their allocation to infrastructure over the longer term. However, with dry powder also at an all-time high of $107bn, there are increasing concerns over the availability and pricing of assets in relation to the amount of capital chasing available investments. These concerns may be impacting the number of deals completed; between Q1 and Q3 2014, 525 infrastructure deals were completed, compared to 670 over the same period in 2013.

Preqin’s Infrastructure Online is an indispensable tool for all firms looking to market funds, develop new business, find new partners or conduct market analysis in the coming months. Behind every data point in this report is a wealth of individual firm, fund and asset-level data available on Preqin’s leading online services.

We hope you find this report useful, and welcome any feedback you may have. For more information, please visit www.preqin.com or contact info@preqin.com.

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How can infrastructure managers stand out in a crowded fundraising market?

Over the last 10 years, infrastructure has emerged as an asset class of its own. Its unique characteristics and the benefits provided to its investors have given birth to a fast-growing group of managers competing for continually increasing allocations. In our opinion, the dynamics are favourable to the emergence of new infrastructure managers. However, as investors have become more selective over the years, managers need to further differentiate themselves.

In order to stand out in a crowded fundraising market, the manager has to be able to clearly express its competitive advantages. How unique is your deal flow? Do you have special negotiating skills? Are you particularly good at identifying good platform assets and combining them to create sector leaders? Are your relationships with the local authorities strong? Is operational enhancement a key part of your value-add? Do you have a track record in obtaining financing from banks and capital markets? These are questions that need to be answered in a clear and concise manner for investors to understand the competitive advantages of the manager.

What are investors’ main concerns about the infrastructure market at present?

Regarding fundraising, the infrastructure investment theme has shaped rapidly over the last decade into a real asset class attracting substantial amounts of capital. According to Preqin’s data, unlisted infrastructure funds closed in 2013 raised $44bn, compared to $30bn in 2012. While the balance between committed and distributed capital is tilted towards the former, distributions have picked up quite substantially. As investors have not yet reached their target allocation, the difference is still being covered by the additional capital being committed to the asset class. In parallel, Preqin shows dry powder standing at an all-time-high of $107bn as of October 2014. A rising investor concern is whether there are too many dollars chasing too few deals. The ability to source proprietary deal flow at attractive prices is a true differentiator.

In addition to the capital raised by unlisted funds, some institutional investors invest directly in infrastructure deals. The combined flow of capital seeking suitable investment opportunities is driving up brownfield asset prices which will negatively impact expected returns. This is particularly true for mature markets such as the UK. Hence, investors’ main concerns about the asset class presently lie both in the availability of new investment opportunities and in the inflation of these assets’ prices.

Are there particular regions or sectors of particular interest to infrastructure investors at present?

Investor appetite for infrastructure has traditionally been directed mainly towards Western markets, with Northern Europe and North America as the main focus of attention. However, a mix of evolving regulations and awareness has now quickly expanded the opportunity set to Southern and Central Europe, Asia and now Africa. Sub-Saharan Africa appears as the “last frontier”, with investors’ awareness of growth potential progressively exceeding concerns about risk. Generalist brownfield funds still attract the bulk of the capital. Region- or country-focused products, as well as credit vehicles, are also now gaining strong traction. In general, investors still favour Western geographies, mainly because of geopolitical stability, sizeable economies and suitable regulatory frameworks. From a sector standpoint, given the boom in the energy sector, energy infrastructure is a rapidly accelerating area of interest.

As the industry matures, in addition to commitments to generalist and global funds, we expect investors to seek out more niche products to diversify their portfolio and access new sectors and geographies. Like all other alternative asset classes, the infrastructure sector will likely evolve like private equity in general, with established larger generalist funds and more specialized offerings.

How do you define a successful fundraise?

A successful fundraise accomplishes several important goals at once. The main objective is to secure capital commitments to allow a manager to execute on its planned investment strategy. In parallel, it also enables the manager to build a long-term, trusting and supportive investor base, balanced across investor types and geographies, which will support the manager over multiple funds.

Depending on the fund size, it should include investors from multiple continents that are regarded as leaders by their peers, and that can act as references for the manager. Some measure success by the speed of a fundraise and number of closes, but an extended fundraise that hits target with a good set of investors should also be considered a success even though it took more time to close. To maximize the chances of success, great care must be taken to execute a well-orchestrated global fundraising effort with clear objectives.

How can a first-time fund manager execute a successful fundraise?

If investors feel strongly about a macro opportunity and they cannot access it through mature platforms, first-time managers
become their only choice. The first step is to take a hard look in the mirror and decide if the raw material exists to successfully complete a fundraise. It is essential to ascertain the right positioning. Is there a good match between a clearly identified, attractive market opportunity and your actual skill set? Is your investment strategy clearly defined and focused, or is it too vague or too broad? Have your team members worked together in the past? Is your track record relevant to your strategy and positioning? Do you have attribution? If not, do you have some demonstrable proxy for your team’s ability to generate attractive returns? How sustainably different is your deal flow? Is your interest aligned with limited partners?

Investors are attracted to experienced teams targeting a well-defined and appealing opportunity. When the team invests its own personal capital, it demonstrates a strong alignment between the manager and investors, and will help limited partners accept the first-time nature of a new venture. Incentives for investors to commit at first closing can also be helpful (such as deals already in portfolio, management fee rebate, co-investment rights, stapled transactions). If you can secure a few anchor investors in a first closing and already provide access to the first investments, it will make your proposal more interesting to the investor community.

If key components of the story are missing, the manager needs to find different ways to do deals outside of a fund structure, either by using non-committed capital from friends and family or other relationships or as an equity-in-kind contributor partnering with an experienced manager to establish a proven track record of successfully sourcing, managing and exiting investments.

How do you build momentum during the fundraise?

Knowing who will be the key supporters and how much capital they could commit in the upcoming first closing is invaluable and probably one of the most important elements to build momentum. It achieves the multiple goals of reducing risk, increasing certainty, and ultimately providing third-party validation of the manager’s credibility. We usually consider that momentum can be generated if we can cross the threshold of 50% of the fund size target in a first closing. However, if a deal is to be done in the fund, a first close can be made at a smaller number, since having a portfolio company in the fund can spark momentum.

Raising capital has truly become a global exercise by default. Diversification is paramount in building a resilient and scalable investor base, because over-reliance on one investor type or geography can cause vulnerability. The main objective of a bespoke investor relations program, beyond serving existing investors, is therefore to increase visibility on prospective investor appetite for the manager’s subsequent offering.

When should fund managers start engaging with investors?

Most GPs have come to the realization that capital raising never stops. As this market is competitive, it is critical to be engaging with prospective investors before, during and after the capital raise. Staying in touch outside a formal fundraise provides many benefits to both parties. Regular contact enables managers to build a long-term, trusting relationship with investors, and to be integrated in their upcoming investment plans. Managers should also take the opportunity to absorb investors’ feedback, appetite and concerns in order to fine-tune their positioning and documentation. For investors, regular contact allows them to keep track of the manager and anticipate its return to the market, as well as to generate co-investment or secondary opportunities. Knowing more about each other further reduces the uncertainty of a fundraise as investors can plan the next fund early on, providing increased visibility on market appetite and optimal timing to the manager.

How and when should an investor address issues? How can they mitigate them?

There are very few “perfect” managers, if such a concept actually exists. Every firm has issues, some more challenging than others. Investors are sophisticated professionals that will discover the issues during their due diligence. Transparency is key in building trust and is the foundation of a fruitful long-term partnership with investors. By being transparent you establish credibility with limited partners and you have the ability to position the issue versus reacting and/or sounding defensive. Discovery of an undisclosed issue is often a deal killer.

How important is fund marketing documentation?

In an ever increasingly competitive market, it is important for managers to develop an institutional message which needs to be consistent, both in content and layout, throughout its documentation. Beyond documentation, coherent communication is paramount. The positioning and the manager’s competitive advantages have to be consistently expressed throughout all forms of communication: executive summary, pitch book, private placement memorandum, due diligence questionnaire, data room, website, press releases, industry papers, articles, interviews, speaking opportunities. It is about building a brand. Industry players have to clearly associate the manager’s brand to a specific positioning and area of expertise.

How do you decide which firms to work with?

Capstone Partners focuses on quality. We advise established funds and emerging managers in all types of strategies and geographies. We are constantly interacting with limited partners, and as a result, have a good sense of what strategies and geographies are of interest to them. As we look at a particular fund, we conduct diligence similar to what limited partners do in an effort to determine the quality of the offering. Our primary areas of focus are team, differentiation of the strategy, alignment of interests and ability to replicate a good track record. Our decision to take on a mandate is similar to an investor committing to a fund, as our time is our capital.

Capstone Partners

Founded in 2001, Capstone Partners is a leading independent placement agent focused on raising capital for private equity, credit, real assets and infrastructure firms from around the world.

Giacomo Biondi Morra di Belforte is a Managing Partner in the European office of Capstone Partners and is responsible for fundraising and origination with a focus on Italy, France, Monaco, Luxembourg and Netherlands.

www.csplp.com
In Q3 2014, 14 unlisted infrastructure vehicles reached a final close raising an aggregate $8.5bn in institutional investor capital (Fig. 1), bringing the year-to-date total to $27bn. This is a slight increase on the $23bn raised over the same period in 2013; however, the number of funds reaching a final close has declined from 41 to 28 over this timeframe.

Of the 28 unlisted infrastructure funds to have reached a final close so far in 2014, North America is the most commonly targeted region, with 14 funds focusing on the region reaching a final close raising an aggregate $19.1bn (Fig. 2). A significant 61% of funds closed so far in 2014 have either reached or exceeded their initial target sizes (Fig. 3). As shown in Fig. 4, several sizeable infrastructure funds closed in Q3 2014, the largest of which was Macquarie Infrastructure Partners III, which closed in September on $3bn.
We have a successful track record in raising capital for **private equity**, **credit**, **real assets** and **infrastructure firms** from around the world.

Our ability to differentiate our clients in a highly competitive market and our longstanding relationships with active investors in North America, Europe, Asia and the Middle East are key to our success.

We are partners with each of our clients, helping them reach the next level in fundraising.
As of the start of Q4 2014, the unlisted infrastructure fund market is particularly crowded, with a record 148 funds in market targeting an aggregate $95bn in institutional investor capital (Fig.1). A considerable 61% of funds have already been on the road for more than 12 months (Fig. 3), with fundraising now a lengthy process for many managers.

The largest funds in market are ArcLight Energy Partners Fund VI and Morgan Stanley Infrastructure Partners II, both targeting $4bn in investor commitments (Fig. 4). Other sizeable funds on the road included the €2bn Pan-European Infrastructure Fund II and the $2.5bn Energy & Minerals Group Fund III.

Preqin’s Infrastructure Online contains detailed information on 148 infrastructure funds currently in market, including interim closes, target size, investment preferences. For more information, please visit: www.preqin.com/infrastructure
Institutional Investors in Infrastructure

Infrastructure remains a growing area of interest for institutional investors. A significant 57% of surveyed investors expect to invest more capital in the infrastructure asset class over the coming 12 months compared to the previous year (Fig. 1), while 87% of surveyed investors plan to either increase or maintain their current infrastructure allocation in the longer term (Fig. 2).

Although unlisted infrastructure funds remain the primary route to market for most investors, 55% of surveyed investors expect direct investments to account for a larger proportion of their portfolio in the year ahead (Fig. 3). Fig. 5 reveals that many infrastructure investors intend to commit large amounts of capital to the asset class in the next 12 months, with 55% intending to invest $100mn or more, and 20% looking to invest $600mn or more.

Preqin’s Infrastructure Online contains detailed profiles for over 2,300 infrastructure investors worldwide. For more information, please visit: www.preqin.com/infrastructure

Fig. 1: Investors’ Expected Capital Commitment to Unlisted Infrastructure Funds in the Next 12 Months Compared to the Previous 12 Months, December 2013 - August 2014

Fig. 2: Investors’ Intentions for their Infrastructure Allocations in the Next 12 Months and the Longer Term

Fig. 3: Investors’ Intentions for the Weighting of Their Infrastructure Portfolio in the Next 12 Months

Fig. 4: Breakdown of Regions Targeted in the Next 12 Months by Investor Location

Fig. 5: Amount of Fresh Capital Investors Plan to Invest in Infrastructure over the Next 12 Months
In Q3 2014, 156 infrastructure deals were completed with a reported aggregate deal value of $51bn and an estimated aggregate deal value of $88bn (Fig.1), although these figures are likely to rise as more data becomes available from fund managers and institutional investors. Notable transactions completed in the quarter include the acquisition of a 50% stake in Ruby Pipeline Holding Company, a 675 mile natural gas pipeline in the US, by listed fund manager Veresen. The stake was purchased from Global Infrastructure Partners for $1.4bn.

**Fig. 2: Breakdown of Infrastructure Deals by Region, Q3 2014**

Europe: 35%
North America: 44%
Asia: 9%
South America: 5%
Australia: 7%
Africa & Middle East: 5%

**Fig. 3: Breakdown of Infrastructure Deals by Industry, Q3 2014**

Energy: 51%
Utilities: 3%
Transport: 3%
Healthcare: 3%
Education: 3%
Social (Other): 3%
Other: 23%

**Fig. 4: 10 Notable Infrastructure Deals Completed in Q3 2014**

<table>
<thead>
<tr>
<th>Asset</th>
<th>Location</th>
<th>Industry</th>
<th>Investor/s</th>
<th>Total Deal Size (mn)</th>
<th>Stake (%)</th>
<th>Transaction Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>A9 Gaasperdammerweg</td>
<td>Netherlands</td>
<td>Roads</td>
<td>3i Infrastructure, Ballast Nedam, Fluor Corporation, Heijmans</td>
<td>700 EUR</td>
<td>100</td>
<td>Jul-14</td>
</tr>
<tr>
<td>Access Midstream Partners</td>
<td>US</td>
<td>Natural Resources</td>
<td>Williams Companies</td>
<td>5,995 USD</td>
<td>-</td>
<td>Jul-14</td>
</tr>
<tr>
<td>Bristol International Airport</td>
<td>UK</td>
<td>Airports</td>
<td>Ontario Teachers' Pension Plan</td>
<td>250 GBP</td>
<td>50</td>
<td>Sep-14</td>
</tr>
<tr>
<td>East West Link - Phase I</td>
<td>Australia</td>
<td>Toll Roads</td>
<td>Acciona, Bouygues Group, Lend Lease</td>
<td>8,000 AUD</td>
<td>100</td>
<td>Sep-14</td>
</tr>
<tr>
<td>Freeport LNG Terminal</td>
<td>US</td>
<td>Natural Resources</td>
<td>Global Infrastructure Partners</td>
<td>850 USD</td>
<td>25</td>
<td>Jul-14</td>
</tr>
<tr>
<td>Interparking</td>
<td>Belgium</td>
<td>Parking Lots</td>
<td>CPP Investment Board</td>
<td>376 EUR</td>
<td>39</td>
<td>Jul-14</td>
</tr>
<tr>
<td>Rampion Offshore Wind Farm</td>
<td>UK</td>
<td>Wind Power</td>
<td>E.ON</td>
<td>2,000 EUR</td>
<td>100</td>
<td>Jul-14</td>
</tr>
<tr>
<td>Ravenhall Prison</td>
<td>Australia</td>
<td>Prisons</td>
<td>John Holland, Lend Lease, The GEO Group</td>
<td>670 AUD</td>
<td>100</td>
<td>Sep-14</td>
</tr>
<tr>
<td>Ruby Pipeline Holding Company</td>
<td>US</td>
<td>Natural Resources</td>
<td>Veresen</td>
<td>1,425 USD</td>
<td>50</td>
<td>Sep-14</td>
</tr>
<tr>
<td>San Gabriel Gas-Fired Power Plant</td>
<td>Philippines</td>
<td>Power Plants</td>
<td>Lopez Holdings Corporation</td>
<td>600 USD</td>
<td>100</td>
<td>Jul-14</td>
</tr>
</tbody>
</table>

Source: Preqin Infrastructure Online
Infrastructure assets under management are currently at their highest point ever, standing at $282bn as of March 2014, a considerable increase compared to 2007, when industry AUM stood at just $98bn, demonstrating the growth of the infrastructure fund industry over this time (Fig. 1). An increase in the unrealized value of infrastructure assets accounts for a significant proportion of this growth, as the large levels of capital raised in recent years has been put to work, and infrastructure valuations have increased. North America-focused funds account for the largest proportion of industry AUM, with $137bn in assets under management, compared to $87bn and $31bn for Europe- and Asia-focused infrastructure funds respectively, as shown in Fig. 2.

In terms of dry powder, North America has seen the greatest increase since December 2013, up from $41bn of uncalled capital commitments to $52bn; in comparison, European dry powder has remained at $33bn (Fig. 3). With fund sizes increasing in recent years, mega funds account for a slightly larger proportion of global dry powder in 2014 to date compared to 2013, representing 43% of dry powder compared to 39% respectively, as displayed in Fig. 4.

Preqin’s Infrastructure Online contains detailed information for over 830 infrastructure funds and over 400 fund managers worldwide.

Access detailed information on the amount of dry powder available to invest, including breakdowns by fund manager location, fund focus, vintage year and fund size.

For more information, please visit: www.preqin.com/infrastructure

Fig. 1: Unlisted Infrastructure Assets under Management, December 2007 - March 2014

Fig. 2: Unlisted Infrastructure Assets under Management by Fund Primary Geographic Focus (As of March 2014)

Fig. 3: Unlisted Infrastructure Dry Powder by Fund Primary Geographic Focus, December 2007 - September 2014

Fig. 4: Breakdown of Unlisted Infrastructure Dry Powder by Fund Size, December 2007 - September 2014
Fund Performance

Despite infrastructure funds typically targeting lower returns than private equity or private real estate funds, infrastructure funds of older vintages have outperformed these strategies, with the median IRR for vintage 2000-2005 funds standing at 17%, compared to 9% for real estate funds and 14.9% for private equity buyout funds (Fig. 2). The relatively strong performance of the asset class is further demonstrated in the PrEQIn Infrastructure Index (rebased to 100 as of December 2007), which stands at 155.5 as of December 2013, compared to 137.1 for the PrEQIn All Private Equity Index (Fig. 3). The median IRRs of infrastructure for funds of vintage years between 2008 and 2011 are relatively stable, ranging between 7.6% and 11.9%, suggesting that, in many cases, these funds are delivering the stable returns that investors look for when allocating capital to the asset class.

Preqin’s Infrastructure Online contains individual net-to-LP performance data for more than 180 named funds. For more information, please visit: www.preqin.com/infrastructure

Fig. 1: Median, Maximum and Minimum Net IRRs for Unlisted Infrastructure Funds by Vintage Year

Fig. 2: Infrastructure vs. Other Private Equity Strategies: Median Net IRR by Vintage Year

Fig. 3: PrEQIn Index: Infrastructure vs. All Private Equity

Fig. 4: Unlisted Infrastructure Funds: Median Called-Up, Distributed and Residual Value Ratios by Vintage Year

Fig. 5: Median Net Multiples of Unlisted Infrastructure Funds by Vintage Year
With global coverage and detailed information on all aspects of the infrastructure asset class, Preqin’s industry-leading Infrastructure Online service keeps you up-to-date on all the latest developments in the infrastructure universe.

**Source new investors for funds and co-investments**

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