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Growth of Infrastructure Funds May Lead to M&A Business

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Countries all over the world are experiencing a growing need to replace or expand their infrastructure -- roads, railways, bridges, ports, airports, power assets, transmission lines, pipelines, communications networks and more.

In the 2007 Canadian federal budget, Finance Minister James Flaherty announced an infrastructure funding commitment of C$33 billion over the next seven years. Similarly, the Ontario government in 2005 announced its five-year infrastructure plan and committed C$30 billion to invest in highways, hospitals, schools and public transit. This is in addition to the estimated C$25 billion to C$40 billion required to refurbish, replace or conserve 25,000 megawatts of power-generating capacity in Ontario by 2020.

Facing enormous costs, governments around the world are looking to the private sector for help -- and infrastructure funds are answering the call.

The Macquarie Group, headquartered in Australia, was one of the first to recognize this opportunity for private sector investment in infrastructure assets. As early as 1996, Macquarie began forming specialized infrastructure funds to acquire and finance infrastructure assets around the world. Macquarie currently manages a portfolio of 102 assets in 25 countries, representing approximately C$35 billion in equity under management.

In 2006, we saw this trend explode with many other private equity firms establishing their own specialized infrastructure funds or groups.

Goldman Sachs raised its first infrastructure fund with more than US$6.5 billion in committed capital.

The Carlyle Group established a team to conduct investments in the infrastructure sector. Carlyle also formed a US$685 million renewable energy infrastructure fund with Riverstone Holdings.

Morgan Stanley established an infrastructure group and announced in February 2007 that it had agreed to acquire a significant interest in two Montreal container terminals.

GE and Credit Suisse announced that they intended to establish a US$1 billion joint venture, Global Infrastructure Partners, to invest in infrastructure assets, and JPMorgan also established its own infrastructure group.

There is no end in sight. In the past few weeks alone, Brookfield Asset Management announced that it is forming a dedicated infrastructure fund, Brookfield Infrastructure Partners; and Alinda Capital Partners, an independent, U.S.-based infrastructure fund managed by a group of former Citigroup employees, announced that it is acquiring the assets of UE Waterheater Income Fund. And this is not just a North American trend. In February, Blackstone Group Holdings, Citigroup and two Indian-based finance companies announced that they had agreed to start a US$5 billion infrastructure fund that will concentrate on roads, ports and other utilities in India.

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Infrastructure funds will face stiff competition for these assets from another class of investor -- the pension funds. Infrastructure assets are particularly well-suited for long-term investors such as pension funds, which have corresponding long-term liabilities. The infrastructure asset class offers long-term, inflation-indexed returns, which typically demonstrate stability over time. Canadian pension plans have for years recognized this potential. Since 1999, Borealis Infrastructure has been identifying and managing infrastructure assets on behalf of OMERS (Ontario Municipal Employees Retirement System). Ontario Teachers' Pension Plan has been investing in infrastructure assets since 2001, and the CPP (Canadian Pension Plan) Investment Board formed an infrastructure group in 2006. Infrastructure funds allow institutional investors such as smaller pension plans, insurance companies, endowments and others that do not wish to invest directly in infrastructure assets to diversify into this important asset class through investing in an infrastructure fund.

As the demand for the replacement or expansion of infrastructure assets continues to grow worldwide, the need for private sector investment in infrastructure will continue to increase. Infrastructure funds provide an ideal vehicle for this form of investment. The growth of infrastructure funds, a trend that accelerated in 2006, will continue in 2007 and beyond.

Following on the success of the current participants in the infrastructure sector, it is likely that additional private equity firms will form specialized infrastructure funds or groups to capitalize on the available opportunities. As these infrastructure and pension funds seek to deploy their capital, M&A in this sector will continue to increase. In addition, with more funds being raised for the infrastructure sector and competition for infrastructure assets intensifying, infrastructure funds may look beyond the traditional definition of infrastructure to assets that have infrastructure-like characteristics and returns. Infrastructure funds will also need to search further and wider afield for investment opportunities.

Canada, with its stable government and low political risk, is well-positioned to access these private funds in order to replace and expand its infrastructure.

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