KEYNOTE INTERVIEW

India's operational infrastructure opportunity

India's National Monetisation Pipeline is generating exciting opportunities to invest in operational, yielding energy and transportation assets, says head of the Edelweiss infrastructure funds business, Subahoo Chordia

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Q How would you describe the scale of the Indian infrastructure opportunity today and what is driving that?
The Indian infrastructure opportunity can broadly be classified into two segments. The first involves building new infrastructure assets, whilst the second involves the investing in or acquiring of existing operating infrastructure assets for yield. Both opportunities are sizeable in India today.

The government has announced a plan to invest $1.5 trillion into greenfield infrastructure assets over the next five years. Private sector participation in this National Infrastructure Pipeline is expected to be around 20 percent or $300 billion of the total. Infrastructure spending in India needs to be above 4-5 percent of GDP to support India's economic growth and the "Make in India" programme. The Indian government is focused on attracting a global pool of long-term capital by providing regulatory and structural support.

The opportunity to invest in existing operating infrastructure is also very large and interesting. It provides regular cashflow yield and growth at time of exit. There are about $300 billion of such assets available with private developers who are monetising these assets to recycle their capital and for growth. The government has also announced the National Monetisation Programme, which has been drafted according to the Australian model. In total, the government is looking to monetise around $80 billion of operating infrastructure assets by 2025.

Q What type of assets are these programmes focusing on?
Around 65 percent of the greenfield development and 65 percent of the

monetisation programme, will be in the energy and transportation sectors. When you also take into account assets owned by private developers, it is still the case that two-thirds of the market is based around these two sectors. We focus on a strategy to aggregate these good quality operating assets into a portfolio that is diversified across sector, counterparties and geographical locations.

Q And where within those two sectors will you be spending most of your time?

We will primarily be focusing on yield-generating, operational infrastructure assets given the development risks involved in greenfield investment. Some of the other factors we focus on while evaluating assets are predictability of cashflows, a long residual life and low operating complexity, ie high EBITDA margins.

Our current portfolio includes operating transmission assets, for example. These assets have long-term contracts through which we receive cashflows.

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We also have operating renewable power assets – specifically solar – in our portfolio. Again, these assets have long-term contracts with fixed tariffs that give us visibility on cashflows for up to 25 years.

The third sector that we are excited about involves highways. There are three models for investment in highways. The first involves annuities. This is a fixed payment made under a concession agreement with the National Highways Authority of India and it means that we don't take any kind of traffic risk. The second model is hybrid annuity. Here, once again, an annuity is paid by the NHAI, but that annuity is linked to interest rates. In a scenario such as the one we face today, with interest rates going up around the world, that provides us with an important hedge.

The final model is a toll model, which gives us a nice hedge against inflation as the toll is linked to the inflation index. Overall, therefore, we look to construct a portfolio that has a mix of inflation-linked, interest rate-linked and long-term contracted assets.

Q How would you describe India's approach to the energy transition, and the opportunities that it's creating?

There has been a huge focus on energy transition in India, particularly as we import a large part of our national energy requirement. India has its own natural advantage in terms of high levels of irradiance which means it is suitable for solar generation. India also has a peak curve for power demand as opposed to the duck curve that you see in Europe. A peak curve means that demand is high in the day because India has a hot climate, whilst in Europe, demand is higher at night.

Obviously, solar power is generated during the day and so this matches up with India's demand curve. The Indian government is therefore placing a great deal of focus on building out solar generation plants.

In addition, we are seeing the evolution of a very interesting storage model that will enable round the clock power. Storage costs are falling, and the expectation is that storage will become a commercially viable product within the next couple of years. We expect that to become a highly attractive deployment opportunity and strategic opportunity for investors like us.

Q How competitive is the investment landscape when it comes to these operational assets?

The market is very competitive if you are looking to buy large portfolios. The global strategics and global pension funds are looking to deploy significant amounts of capital in this interesting space which is driving up valuations.

However, there is a second strategy that involves value creative asset aggregation strategy, where investors have to build platform from the ground up to acquire mid-sized assets and create a large portfolio. With this value creation strategy, it is possible to generate higher returns with a similar risk profile because competition is relatively lower and it requires a local presence to source these mid-sized deals. The global players do not find it meaningful to look at these smaller deals.

Q Beyond your asset aggregation strategy, how else do you look to differentiate Edelweiss from origination through to asset management?

The asset aggregation strategy that we employ requires a direct sourcing model. That means having boots on the ground is important. This is not particular to India, of course. It has played out in the same way in other parts of the world including Europe and the US. But having that local presence has certainly been an important differentiator when compared to some of our larger competitors and we believe it has helped us generate higher returns.

The second aspect that I would point to, involves our approach to asset management. Since we aggregate these assets from mid-sized developers, there is typically an opportunity to enhance returns by improving both financial and operating efficiencies. Effective use of technology post-acquisition for predictive and proactive maintenance has also helped to improve availability thus enhancing value.

These are assets that were predominantly owned by construction companies and so, funds like us can provide that asset management expertise post-acquisition in order to enhance yields. In fact, our first fund has improved yields by close to 200-300 basis points through the asset management phase.

Q What are some of the challenges that you would associate with investment in the Indian infrastructure market?

One of the most notable challenges we see is a lack of stability and predictability in the deal pipeline – especially in terms of availability of government assets. I believe that this should get addressed to some extent through the National Monetisation Plan.

There are few sizeable platforms available to invest in in India and those that are available command premiums as a result of that scarcity.

Q And are there any particular ESG considerations to bear in mind?

ESG is a very important consideration in the context of the Indian market. For most of the infrastructure developers in India from whom we buy these assets, following appropriate ESG standards comes down to individual discretion. Thus, the sellers of those assets may not have been ESG compliant.

However, funds like us are an exception. We have to be ESG compliant as we are buying these assets from a "buy and hold" perspective and hence sustainability of the underlying business is critical for us to evaluate. Also, since we have capital committed from institutional investors from Europe and the US, our awareness and focus on ESG is also high. It is therefore something that we take very seriously.

It is therefore critical for us to do a thorough ESG diligence of an asset prior to making an investment. Also post-acquisition, it is equally important to put an action plan in place to improve an asset's ESG score. We might also have to walk away from an opportunity that does not meet our ESG norms.

Q You mention investors from Europe and the US. What changes have you seen in terms of investor appetite for this market and what is driving that?

Investor appetite has gone up across the globe but is particularly apparent in Europe, the US and Canada. This interest is quite evident when we look at the institutions that have invested money in Indian infrastructure assets or platforms. Investors like Allianz, CPPIB, OTPP, OMERS, BCIMC, Brookfield, KRR, and others have invested into these large operating portfolios.

Interest from strategics has also increased. Shell, for example, just acquired a large renewables platform. So, we are seeing significant appetite from global investors and there are further deals in the pipeline that will be announced soon. And the reason for all this interest? Investors have made strong returns on operating, yielding assets in India in recent years.

That has naturally created a lot of comfort in the international investor community. They recognise that this is a market where money can be made.

Having recently spent time in both Europe and the US, I would add that understanding amongst global investors about Indian infrastructure assets has increased significantly, as those investors have gained exposure to the market through global funds. They realise that operating assets generate returns and that the risks are low. There is also increasing realisation of the fact that the regulatory environment in India has matured as far as the infrastructure sector is concerned. ■