Infranity's 2023 outlook

"Energy Revolution, Digital Evolution and Opportunities Galore"

In 2022, infrastructure investors experienced once again the resilience of their investments under duress as their assets exhibited significantly lower volatility during the most tumultuous periods. In 2023, a combination of strong economic demand (especially around digitalisation and transportation), social convictions (the move towards greener and more sustainable solutions) and political support (particularly with regards to energy transition) will keep driving the fundamentals of infrastructure investments.

In this, the new year is no different from recent years and we expect those trends to continue long into the future. However, due to the Russian invasion of Ukraine last February, the strategic question regarding the energy provision of Europe has jumped to the fore. The impact of spiraling energy prices, sanctions, output reductions, et al. have triggered a tectonic rethink in how to procure energy sustainably and in greater autonomy.

As a consequence, we see 2023 as the year of energy transformation in Europe. There has already been a trend towards greater adoption of renewables and decarbonisation, which attracted significant capital flows in the past, but now the energy revolution has truly begun. In light of a geopolitical landscape with elevated threat levels regarding energy supply, we see an acceleration that is increasingly channeling capital to decarbonise "dirty" assets, especially coal but also gas, and increase alternative sources of energy production. Solar PV (photovoltaics) are a cleaner substitute and in tune with societal goals. Many capital-hungry, experienced developers have consolidated pipelines of projects (pre-build) and are teaming up with private equity investors to drive platforms to IPP (Independent Power Producers) models. This is backed by a strong government push to simplify permitting processes accelerating the pipeline of PV asset across Europe. We have visibility of at least 25GW (€20bn capex) of greenfield assets that require funding on a pan European level with capital needs across senior IG (investment grade), sub-IG and equity.

Offshore windfarms, facing less communal opposition than their onshore brethren, are accelerating their build-out, particularly in the most established markets in Europe, such as the UK (11GW of already installed capacity), Germany (8GW) and the Netherlands (8GW). Germany, given its dependence on Russian energy, has increased the offshore wind target for 2030 by another 10GW, to total of 30GW. There are robust deal pipelines in Poland and the Baltics as well with strong government backing. We also see innovation in the form of a tentative move to floating offshore off Europe's Atlantic Coast and in the Mediterranean - with tenders launched in France, Portugal, Spain and Italy.

Biogas investments, a ready replacement for dirtier natural gas, are accelerating, too. Pressing EU targets to get to over 20% of biogas replacing natural gas in European gas consumption are meant not only to be greener but strategically important as they reduce the reliance on imports, be it from Russia or via expensive LNG solutions. The sector is 'coming of age', moving from small scale farm-based assets to landmark transactions of over €1bn volume. Long-term government support schemes for agricultural and food waste

sourced plants are in line with the EU directive to source segregate food waste and so profit from specific regulatory support.

Distributed generation solutions, like residential rooftop PV including storage and charging facilities, are being deployed at scale by platform investors across Europe. Given today's energy prices, limited or no government support is needed to make the economics work. We see particularly Germany and Spain growing fast in this area, but other European markets are expected to catch up, too.

And finally, larger and more efficient energy storage solutions – a sector of special activity in the UK (e.g. batteries) and Italy (e.g. gas) already – will become more prevalent in the future. Better storage solutions contribute to greater resilience of the energy system and increase its efficiency. At the same time, the overall flexibility is meant to grow, with a renaissance of nuclear energy production and accelerated efforts to establish a hydrogen economy. All those systems have to come together and will need a grid that can cater to the different characteristics of energy production technologies and support flexible distribution.

Besides the energy revolution, we expect the digitalization trend to continue and evolve further. The Covid-19 crisis highlighted the need for efficient digital and efficient cloud infrastructure. It also unearthed new societal preferences on how to live and work together. Data center and broadband connectivity, fiber in particular, face an enormous supply-demand gap and thus require massive private investments over the next many years. Corporates still have a long journey ahead of them to outsource their IT and bandwidth-hungry applications are expected to continue their advance.

From an investment point of view, it is interesting to note that the tendency to replace banking financing with other means of providing capital, especially via long-term orientated investors, continues. We see a particular demand for HoldCo-level debt financing as increased interest levels are leading banks to be more cautious with their capital, especially in face of ongoing geopolitical and financial market uncertainty.

What do we worry about in 2023? Outside of geopolitical tail risk events or surprises, we are cautious. Wary, on the one hand, of the high capital demand attracting less experienced and less disciplined investors, and, on the other hand, project owners overstretching as they compete for capital. In an accelerating yet still uncertain environment, where volatility shocks seem to lurk around every other corner, the need for capital and the competition for it could too easily lead to unhealthy risks in the system. Combine this with a flurry of regulation, re-regulation and deregulation and one could see how easily all the activity could clog the system, or worse, derail the high attractiveness it has for investors, which is needed to achieve the goals that governments have set.

So, while we remain overall optimistic based on the historical outperformance of infrastructure assets, particularly in times of higher volatility, and the strong undercurrents that promise a healthy deal-flow, we keep our eyes open to avoid the potential pitfalls that are so easy to miss in a complex asset class.

Patrick M. Liedtke, Chief Client Officer & Chief Economist, 16 January 2023

About the author:

Patrick M. Liedtke, Chief Client Officer & Chief Economist

Patrick became Chief Client Officer & Chief Economist of Infranity in 2022, joining the Executive Committee.

From 2012 until 2021, he held several senior regional and global leadership roles as Managing Director at BlackRock, among others Head of Financial Institutions Group (FIG) for EMEA, Head of Institutional Client Business for EMEA, member of the FIG Global Executive Committee and the Global Institutional Client Leadership Committee.

Patrick had joined The Geneva Association in 1998, after a career in capital market analysis and economic research, and in January 2001 became Secretary General and Managing Director, steering the organization to become the leading global strategic research centre for the insurance industry.

Patrick is the founder of different industry bodies including: the Chief Investment Officers Network, the Financial Directors Network, the Amsterdam Circle of Chief Economists and co-founder of the Chief Risk Officers Network in insurance.

Patrick Liedtke graduated from the Technical University of Darmstadt in electrical engineering and financial economics. He is Visiting Professor for Risk and Insurance at Bayes Business School, City University, London.

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