

# A GRANULAR VIEW ON GLOBAL INFRASTRUCTURE

## ENHANCING INFRASTRUCTURE'S APPEAL

**A selective approach to segments and assets is gaining traction within a well-regarded asset class.**

Infrastructure has never shone brighter. With its supportive demand and supply fundamentals, as well as its multiple portfolio benefits, such as steady yields, growth and inflation protection, it continues to attract institutional allocators. As the asset class evolves, many investors are pursuing a more granular path on specific — and potentially more stable — strategies, working with asset managers who bring a differentiated approach. That could mean focusing on a segment, like the lower middle market, or on essential services that demonstrate long-term stability.

“Resilience is at the top of investors’ agenda at the moment. As we have gone from one geopolitical crisis to another, infrastructure has demonstrated that resilience,” said Dominic Helmsley, head of economic infrastructure at Aberdeen Investments, which focuses on the lower middle market. That resilience is underpinned by the ongoing global need for new and replacement infrastructure projects and facilities, which also further societal goals. Aberdeen is seeing a resurgence of interest in allocating to European strategies accessed through managers who have local expertise, versus global fund managers.

Institutional investors favor infrastructure because it can provide more stable cash flows, inflation protection and diversification away from public markets, said Brian Collett, managing director of strategic engagement at I Squared Capital, a global infrastructure investor dedicated to investing in the middle market. “That’s what infrastructure does and why people are adding it to their portfolio.” But infrastructure is much more than just a derisking investment with a stable cash flow. Its unique position derives from its exposure to assets with two key components: “essential demand and a defensible competitive position, or moat,” he said. I Squared invests in middle market companies valued between \$300 million and \$1.5 billion and that can demonstrate strong downside protection, while also capturing these durable growth opportunities over the long term.

### The LMM sweet spot

For a European lower mid-market core and core-plus strategy, Aberdeen typically targets equity cheques of €50 million to €100 million (\$58 million to \$117 million). That market segment is often overlooked by asset managers focused on larger infrastructure enterprises, so there is less competition, Helmsley said. The strategy is diversified across energy, transportation and digital enterprises.

Having access to a robust primary deal flow in the lower middle market is a key differentiator for Aberdeen. It has developed long-term partnerships with local European municipalities and innovative companies in renewable energy. “That gives us access to a unique pipeline of further opportunities and produces a return premium,” he said. “The supply-and-demand fundamentals and unique deal sourcing allow us to offer better risk-adjusted returns from that small- to mid-cap space.”

Another rationale for its small- to mid-cap focus is that it offers greater possibilities for majority or significant minority controlling stakes, said Ruairi Revell, head of sustainability,

infrastructure at Aberdeen Investments. “We underwrite these businesses on an as-is basis, with a core and core-plus risk profile. The lower mid-market gives us access to value-creation levers through active ownership, but we do not need to price that upside into the base case on day one.”

Several infrastructure companies in this space provide services for the transition to the low-carbon economy — one of Aberdeen’s key investment themes. “The combination of our ability to drive value-creation actions as well as the nature of these companies plays into our strategy,” Revell said.

### Finding durable advantages

Across its global platform, I Squared Capital takes an active, differentiated approach to identifying, building and scaling infrastructure businesses that deliver essential, long-term services. In transportation, for example, “we own a school bus company,” Collett said. “Children need to be picked up from school regardless of the performance of public equity markets. That’s the essential service.” I Squared pairs that essentiality with defensibility. “We look for a moat, by which we mean there is protection, either physical or contractual, around the service,” he said. In this case, the moat is the long-term contract with the school district, creating visibility and resilience in cash flows.

It is this combination — essential services underpinned by durable competitive advantages — that drive both predictability and long-term value creation. “We need to be selective when we’re picking our investments. This involves making sure that moat is there for the essential service, and that it’s protected over time,” Collett said.

The same discipline shapes the firm’s approach to the ongoing artificial intelligence build-out. “We have steered clear of mega data centers used for training models. These tend to operate at 100 megawatts or higher,” he said. Instead, I Squared focuses on the smaller “edge” data centers of less than 20 megawatts, where the trained models are run. These facilities are designed to reduce latency and improve response time for streaming, he said, adding that the firm is expanding in this space across Europe, Asia and the U.S.

I Squared’s nuanced approach to data center investing comes back to its key focus on identifying essential services with a moat. While the long-term demand for AI infrastructure is clear, the durability of competitive advantages in large training facilities remains uncertain. “We are less convinced of the moat around large data centers,” Collett said. “We are more comfortable with smaller edge data centers, because they are likely to remain essential infrastructure for the foreseeable future. They have a moat, and that’s where we see both resilience and growth.”

### Addressing liquidity

For some allocators, the comparative and inherent illiquidity of infrastructure has been of concern, both for the wealth channel, as more individual investors have exposures to private assets, and some institutions that have seen delayed distributions.

Infrastructure today has a more liquid and growing secondaries market that supports the overall asset class, said Aberdeen’s Helmsley, though he cautions against relying on this liquidity in a crisis situation. More investors coming into the asset class has also helped create a more liquid exit universe for Aberdeen, Revell added. “There are more exit options for us, another strength of our strategy.”

Given the liquidity considerations for the wealth channel, more evergreen fund structures have emerged for private assets. I Squared's evergreen funds, structured to align with the illiquid characteristics of infrastructure, are designed to offer periodic liquidity, with redemption opportunities typically offered on a quarterly basis and generally capped at a preset level every quarter, Collett said. "The structure of evergreen funds is designed to allow some, but not total, liquidity. After all, by their nature, these are long-duration assets."

The evergreen structure can also be advantageous from the investor's point of view, because it avoids forced selling to meet redemptions. The liquidity levels are designed such that managers should not be forced to sell an asset simply to provide liquidity, he noted.

## SCANNING A LARGE PLATFORM

Investors can consider a wide menu of choices along the risk-return spectrum and are seeking out managers with specialized expertise.

An allocation to infrastructure brings with it many decisions for investors who have specific risk-adjusted return targets: Equity or debt? Broad segments or specialized niches? Global, regional or local? Large, mid-market or small segments?

Even in today's headline-grabbing AI space, for instance, where the mega data centers are attracting record investments, investors are concerned about hyper-competition and the potential for diminished returns. To help them best navigate the infrastructure space, allocators are seeking out asset managers who can demonstrate a selective and consistent strategy combined with deep market knowledge in less publicized sectors, and who can uncover durable investment opportunities.

### Across the spectrum

Infrastructure investments span across the risk-return spectrum of core, core-plus, value-add and opportunistic. "We tend to invest in the core-plus and value-add in our equity portfolio, and more in the core space in our debt portfolio," said Collett at I Squared Capital.

I Squared invests across the full infrastructure landscape, including power and utilities; transportation and logistics; digital infrastructure; environmental infrastructure; and

social infrastructure. "We combine sector and regional expertise," he said. "Capital isn't confined to one sector — opportunities shift and we position ourselves to move with them, whether that is by sector or geography." He added that the sectors do not map neatly to a fixed risk-reward profile; rather, outcomes depend on a company's stage of development.

The energy transition remains a key theme for I Squared, particularly in Europe, where the firm sees strong momentum, Collett said. The firm is doing fewer deals in the U.S., which "is not zero, but it is slower than just three or four years ago." One example in the U.S. is an investment in recycled tire materials used for playground surfaces. "That's a profitable business with an environmental theme that's not typically classified as being part of the energy transition," he said.

### Focus on sustainability

Aberdeen's infrastructure platform offers a breadth of strategies that can meet diverse institutional portfolio needs, from global equity and emerging markets to energy transition and disruptive technology. The sustainability themes continue to be key in Europe — and for Aberdeen — despite the tumultuous period for sustainability in the U.S. "Our approach to sustainability is pragmatic. We treat sustainability factors as drivers of risk management, resilience and value creation, and we back transition where it's commercially durable," Revell said. Aberdeen's investments aim to transform infrastructure from "brown to green" in a way that supports both commercial and sustainability goals, he said.



“Successful infrastructure investing starts with how you source and execute deals. We are a global firm, but very local when it comes to execution.”

—Brian Collett  
I Squared Capital

# I Squared's Infrastructure Equation

DISTINGUISHING ESSENTIAL SERVICES FROM DURABLE BUSINESSES



ESSENTIAL DEMAND



MOAT



INFRASTRUCTURE

Not every essential service is a good investment, in our view.  
Infrastructure becomes compelling when demand is essential and the economics are protected.

### ESSENTIAL DEMAND: SERVICES THAT MUST WORK

- Used every day
- Critical to society or economic activity
- You notice immediately when it fails
- Needed in good times and bad

### MOAT: WHAT PROTECTS THE ECONOMICS

- Physical Moat**
  - Hard to replicate or bypass
  - Limited routes, locations, or access
- Contractual / Structural Moat**
  - Long-term agreements or regulated frameworks
  - Predictable, visible revenue
  - High switching costs or embedded relationships

For example, Aberdeen has found value in infrastructure that sits alongside data centers, he said. At Outokummun Energia in Finland, one of its district heating businesses, the firm has developed a project to co-locate a small data center on site and feed the waste heat into the local heating network. In this case, the project is expected to reduce dependence on combustion-based fuels by up to 50%, while also lowering fuel costs and increasing electricity distribution volume. “That is exactly the kind of opportunity we like, where decarbonization, resilience and commercial value creation reinforce one another. It also lets us benefit from data center growth without needing to invest directly in hyperscale facilities.”

A more recent refocus within sustainable investing has been a slight shift by allocators away from decarbonization as their main priority and more towards resilience and affordability, Revell said, particularly in light of the recent energy crisis stemming from geopolitical volatility and war. Aberdeen’s bio-methane project in Italy is an example that has achieved these wider priorities, Helmsley added. Currently, gas produced by agriculture waste, including chicken and cow manure, is burnt for heat. But new technology used in this project allows extraction of pure methane, which is then fed into the gas grid of Northern Italy. “Since the war with Ukraine, Italy and the EU nations are concerned about energy security. They also want to boost their green fuels,” he said. “But ultimately, affordability is key as well. In the bio-methane project, brownfield assets are converted to an even greener technology, while also providing energy security at an affordable price for the population.”

## DIFFERENTIATED CAPABILITIES

### What’s behind the expertise that allows infrastructure managers to deliver consistent performance?

Success in infrastructure investing is driven by managerial capabilities that can go well beyond investment strategy and asset selection. A unique deal pipeline, an owner-operator capability, a global platform with regional and local expertise, a robust downside risk-management process — all these and more comprise attributes that institutional allocators are seeking in their asset managers.

### The PE playbook

Core infrastructure originally started as bond-replacement investment, pointed out I Squared’s Collett. Private equity demonstrated that business improvements were a way to enhance the returns of underlying companies, and “we’re following that private equity playbook to bring improvements to the infrastructure space.”

“The real work starts after the transaction closes,” he said. As an active owner and long-term “platform builder” across its investments, I Squared works closely with management teams to strengthen operations, refine strategy and unlock growth. “We aim to buy small- to mid-cap assets, invest in them to grow and scale the business, and eventually, when the time is right, sell them to a variety of buyers, whether they are other infrastructure managers or strategics.”

Origination is key as well, Collett said. “Successful infrastructure investing starts with how you source and execute deals. We are a global firm, but very local when it comes to execution.” I Squared’s teams in nine offices around the world are local investors that know the market and will often be the first ones to reach out to businesses that might be interested in selling.

### Partnership power

The strength of Aberdeen’s mid-cap infrastructure strategy rests in part upon its network of 17 senior advisers with local and industry expertise, as well as deep and long-term corporate and municipal partnerships in target geographies. Taken together, this foundation has given it a unique capability in deal-sourcing and in operating companies, Revell said.

“Primary deal flow is something investors are putting weight on. They are looking for managers that have genuine sourcing advantages,” he said. Aberdeen is “able to access deals before they become deals. Origination is where our strategy comes into its own,

and we can originate deals that others don’t see.” About 90% of Aberdeen’s deal flow is primary, versus buying assets from another financial institution at a bank-led auction, he noted.

An example is Aberdeen’s privatization of municipal utilities across Finland. “While we have not always been the highest bidder, municipalities have seen our approach and the expertise that we bring with our advisors. We’re now well known in the Finnish market and are effectively the partner of choice for this kind of transaction.”

For more than 10 years, Aberdeen’s infrastructure assets across 21 European and U.K. projects have averaged 8% annual growth in earnings before interest, taxes, depreciation and amortization. These businesses require active management, said Helmsley, adding that it puts great emphasis on “value creation, particularly around management selection and board effectiveness.”

Its operational approach goes well beyond assessing a company’s management team capabilities. “We insist upon one or more non-executive independent directors on the board of every company, with specific sector expertise of the particular asset in a particular geography,” Helmsley said. The firm also regularly reviews board effectiveness in a rolling three-year process.

Aberdeen’s infrastructure approach has paid off across regional markets where “we are a partner of choice as a patient capital provider for smaller-scale privatizations in the Nordics,” Helmsley said. “Our track record of value creation over time is repeatable and is supported by our own team and our senior advisors. These are key things which make us unique.”

### Holistic view

Looking ahead, infrastructure is expected to continue on its growth path as a core asset in institutional portfolios, given its key attributes of yield, stability and societal impact. Aberdeen’s Revell forecasts that “the lower mid-market will remain attractive relative to the other parts of the infrastructure investment landscape. That’s where we see most of the deal flow and value creation opportunities as well.”

An emerging trend among some institutional investors is a shift toward a total portfolio approach, or TPA, which could further support allocations to infrastructure, Collett said. Unlike traditional strategic asset allocation, TPA evaluates investments holistically, assessing risk and return across the entire portfolio.

“As asset owners adopt TPA, they’re comparing assets across the portfolio and no longer in silos. That could address a long-standing challenge for infrastructure as there never has been a clear place to categorize it,” he said. Infrastructure is not typically classified as private equity nor real estate, even though I Squared’s investments have components of both, Collett pointed out. Infrastructure is also often placed in the real assets bucket, which tends to be dominated by real estate managers.

Under TPA, infrastructure will be evaluated by its unique performance regardless of where it should be bucketed, Collett said. “TPA should be a tailwind for infrastructure. Investors will spend less time worrying about where it fits and instead look at the underlying characteristics of the investment.” That could lead to bigger infrastructure allocations as investors “will realize its value in their total portfolio.”



“The supply- and-demand fundamentals and unique deal sourcing allow us to offer better risk-adjusted returns from that small- to mid-cap space.”

—Dominic Helmsley  
Aberdeen Investments



Sponsored by

