

Anatomy of an Unlisted Infrastructure Asset Acquisition

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by Michael Mileo

There is a significant volume of unlisted Australian Infrastructure Assets across all major infrastructure sectors. However, it is not always easy for prospective investors to find acquisition opportunities for a multitude of reasons.

This very brief article outlines a few of the challenges to be overcome in improving the likelihood of successfully completing an appropriate investment in unlisted infrastructure.

Getting a seat at the table

As part of our valuation work with funds managers around Australia we've come to appreciate how challenging it can be for an 'outside' prospective shareholder to acquire an equity position in a sizeable unlisted infrastructure asset.

Major privatisations aside, such as the recent transactions for the Port of Brisbane or Queensland Forests, equity

positions in unlisted infrastructure assets often change hands without any significant publicity or notice. Therefore unless prospective investors are proactively approaching shareholders in unlisted infrastructure, they may be missing out on value creating opportunities.

Additional challenges exist where certain shareholder agreements provide existing equity holders with pre-emptive rights to acquire a co-shareholder's position that is offered for sale.

It is clear therefore that a proactive identification and approach of potential targets is an ideal way to enhance the opportunities for successful investment. While there is no guarantee the proactive approach will eliminate the challenges of pre-emptive rights, it will at the very least, signal the intent and parcel appetite for infrastructure acquisition.

Know your market

In addition to the pre-emptive rights, we would ordinarily expect existing shareholders to be at a substantial advantage in terms of information asymmetry through their pre-existing board representation entitlements. Investment decisions made with significant information asymmetry can lead to acquiring an inappropriate asset, or the right asset at the wrong price. Consequently, there is substantial value in eliminating information asymmetry.

In the event where available pre-emptive rights are not exercised and the available stake is a small equity position (say up to 10%), a prospective investor may not have the benefit of a dialogue with management as the exiting shareholder may not have this entitlement.

We have learnt that experienced investors can respond to information uncertainty by reducing the level of their bid prices – sometimes expressed as an 'alpha' factor in the discount rate to adjust for what Donald Rumsfeld once described as the "unknown unknowns". While this might seem a relatively blunt instrument response to this challenge, it does offer a cushion for returns should some of these factors come to light at a later date.

The potential downside for investors adopting this approach is that the bid process is a time consuming and expensive (both in cash and opportunity cost terms) undertaking. If a discomfort around asset/market knowledge is driving the bid prices lower, then it is possible that value creating deals are being lost because the bid prices are not meeting the levels justified by well-informed competing bidders.

In this scenario, infrastructure investors can inadvertently put more pressure on returns from their existing portfolio by increasing cash outflows/resources to fund the acquisition process.

We would expect then that knowledge has significant value both in terms of the lowering of investment risk and the efficient investment of cash applied to bid costs.

Market values – where is the data?

Reliable transaction data for unlisted infrastructure is a highly prized source of competitive advantage amongst investors. It comes as no surprise then that data is typically kept close to the chests of the parties involved.

In addition to the availability of the headline price, you can expect that the key terms underpinning the transaction price will invariably also remain confidential.

With such a paucity of data available for unlisted infrastructure, it is usually incumbent on the vendor and investor to reach their respective conclusions and positions on price and terms.

From an investor's perspective, this usually translates to a need to establish a bid range from first principles; by this we are referring to a fundamental approach to the pricing of risk and flexible bases for dealing with uncertainty (even for infrastructure) around cash flows.

We understand from discussions with some of our client base that this process may simply reflect a high level estimate based on the perceived return requirements. As we mentioned previously, perhaps this approach runs the risk of both missing out on valuable opportunities and also the opportunity to look to other market evidence to corroborate a contemporary expectation of required returns.

In the absence of direct empirical data for market values, the challenge is to source supportable bases for pricing risk. Overcoming this challenge in a critical manner typically involves formulating robust bases from comparably risky assets where market pricing is transparent.

To do this effectively, can for example, involve a critical analysis of the underlying volatility of the cash flows and matching this profile to that of other assets, sometimes in different sectors if necessary.

In our experience, nothing supports a negotiation position better than defensible and empirical market data.

Summing up

Successful unlisted infrastructure asset investment is a challenging domain. While supply is reasonable there are a number of characteristics that combine to present significant obstacles to sourcing and executing value creating acquisitions. These challenges include:

- the long term holding period of investors;
- the pre-emptive positions held by existing investors;
- the ability to deploy a comprehensive due diligence process;
- pricing with certainty in the absence of target information;
- prioritising the acquisition opportunities (and therefore investor resources) that are most likely to yield a positive outcome; and
- obtaining robust and defensible market data to support a bid and negotiation position.

Value Adviser Associates can offer a wealth of experience and intimate infrastructure market knowledge for clients seeking to acquire or divest infrastructure assets from a perspective of independence.

For an independent, confidential discussion call one of our experienced team members on 1800 912 226. 



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