



# Deals Infrastructure Highlights

April 2024 Edition





Following the inaugural Deals Infrastructure Newsletter released in November 2023, in this second issue, we focus on the below themes we see unfolding in the infrastructure space:



**Global perspective** – Insight from specialists on the global infrastructure capital deployment and investment performance during 2023 and what is exciting us about 2024.



**ESG lens** – Nature to follow Climates' lead.



**Agri in focus** – Is it time to consider Agriculture a core plus asset class?



**Deals Strategy and Operations insight** – Demystifying carve-outs – How to create value in infrastructure transactions.



**Tax** – Changes to taxation thin cap rules and how that will impact gearing.



**Valuation insight** – How are market indicators driving our views on the Australian long-run nominal risk free rate?







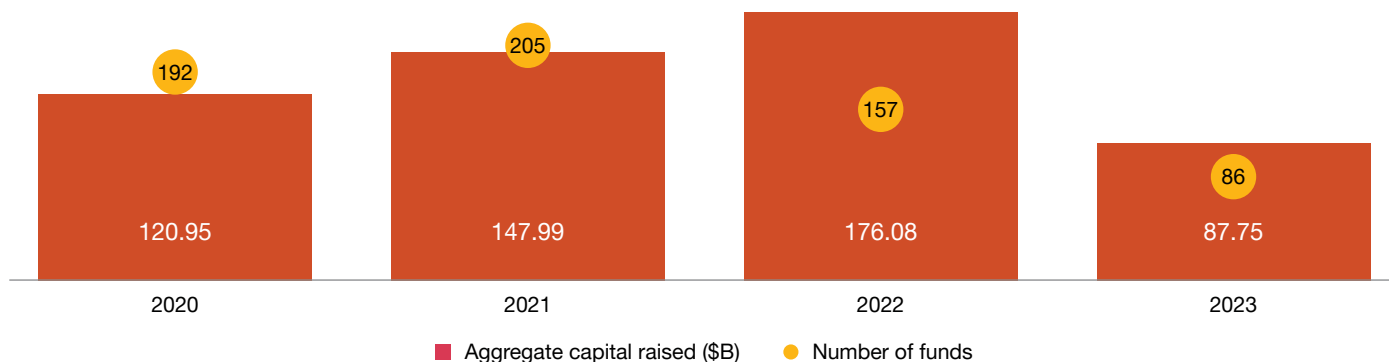


# Global perspective

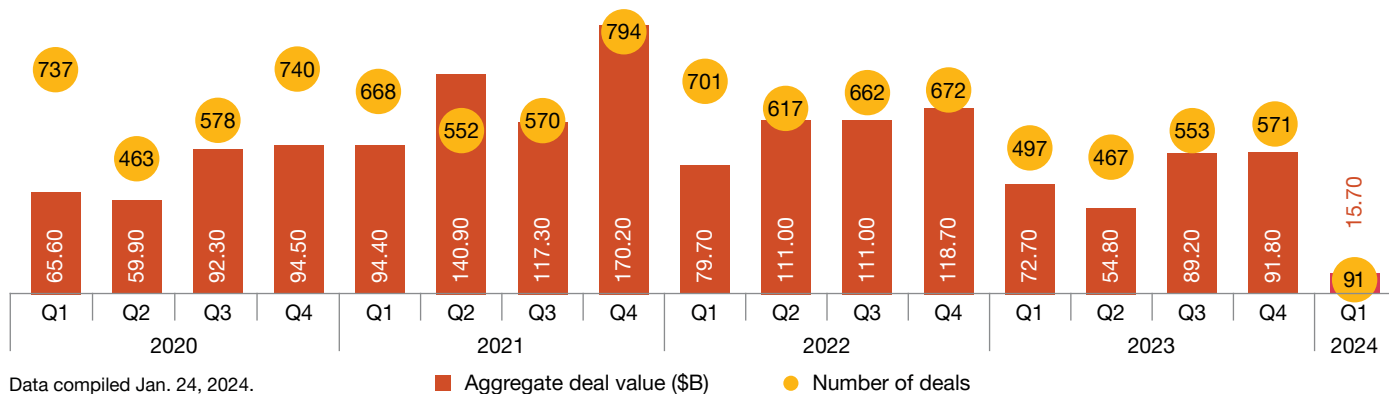
## Pause and reflect – 2023 witnessed a slowdown in infrastructure transactions, albeit with resilient returns<sup>1</sup>

As global economies transitioned from historically low interest rates over the past decade, deal activity was impacted as investors focused on prudent capital allocations and performance targets. Infrastructure transactions demonstrated resilience during 2023 with US\$309 billion in deal value, noting this was ~27% lower than US\$420 billion achieved during 2022. Whilst investment varied by asset sub-class, type of transaction and region, declines in transport and energy midstream during the year were offset by increases in energy transition and renewables transactions, coupled with strong focus in the digital infrastructure space.

### Global infrastructure fundraising, 2020-2023



### Global infrastructure deals, 2020-2024



Data compiled Jan. 24, 2024.

<sup>1</sup> S&P Global Market Intelligence



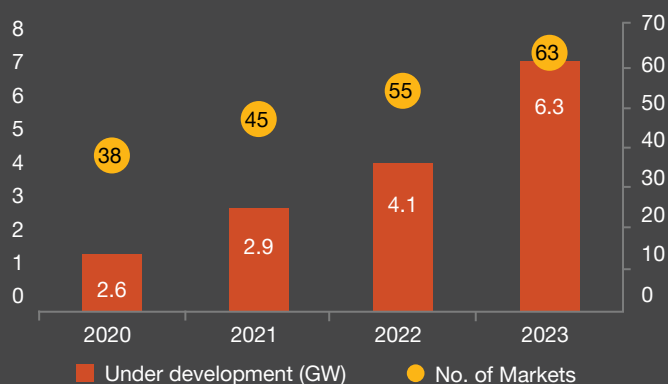




Some of the underlying themes that impacted 2023 performance across infrastructure asset classes included:

- Higher interest rates during the year added complexity to deal economics and funding, whilst volatility from underperforming equity markets during 2022 impacted portfolio weightings with rebalancing of infrastructure holdings well into 2023.
- Continuing gap in valuation expectations between buyers and sellers, resulting in fewer auctions, drawn-out sale processes. We also saw many asset owners exhibiting reluctance to exit from high quality assets in a market with downward pressure on transaction multiples and instead preferred to hold on.
- An increasingly complex geopolitical situation in Europe compounded by conflict in the Middle East, driving conservatism with regards to timing of capital allocation.
- A tale of two halves with regards to fundraising, with ~US\$72.5 billion raised during the second half of 2023 dwarfing the ~US\$15.3 billion raising during H1-23, driven partially by delays in target close dates. Overall, we witnessed a significant decline in private infrastructure fundraising by 50% during 2023, after a record haul of ~US\$176 billion during 2022.
- Whilst Deal volumes across the sector were subdued, we did see a level of activity across public to private transactions and corporate carve out activity leading to bilateral transactions, which contributed to activity in the energy transition space.

#### Data Centres – Ongoing ramp up<sup>2</sup>



<sup>2</sup> Cushman and Wakefield





## 2023 performance drivers

### Utilities



- Indexation, regulated tariff determination
- Extensive capital deployment needed in electricity networks to support energy transition – noting lag in return on capital

### Renewables and energy transition



- Robust support from governments and policy makers (e.g., RED III (EU), IRA (US), Capacity Investment Scheme (Australia))
- Stronger momentum on energy transition due to alignment of goals between governments and the private sector on climate change, energy security (e.g. import dependent economies) and integration of sustainability goals within business strategies

### Transport



- Contracted escalation
- Deblocking of supply chains (ports); catch up in passenger volumes (toll roads and airports) to pre-COVID-19 levels

### Midstream



- Contracted tariffs and volumes
- Capital allocation/returns impacted as investors navigate complexities of ongoing energy transition associated with gas infrastructure assets

### Digital infrastructure



- Higher utilisation and extensive build out of data centres across the US and Asia
- Focus on hyper scale opportunities driven by technological shift from generative artificial intelligence







## What is exciting us about global infrastructure in 2024?

- Mega deals, and 2024 may become a consequential year with BlackRock's acquisition of GIP which manages over US\$100 billion in infrastructure AUM, making the combined AUM well over US\$150 billion. The deal was announced in Jan-24 and could pave the way for other infrastructure owners to consider partnerships. This deal comes off the back of the announced acquisitions of DIF Capital Partners by CVC and Energy Capital Partners by Bridgepoint in Sep-23. These transactions give overall confidence to the future of the asset class.
- Broader consensus that dominant themes of deglobalisation, decarbonisation and digitisation will shape the infrastructure market in 2024 and beyond.
- Whilst public sector impetus such as the landmark Inflation Reduction Act in the US and adoption of the Renewable Energy Directive (RED III) by the European Council are driving a substantial investment in energy transition, transport and renewables, private capital and expertise will be necessary to bridge the gap in infrastructure requirements over the next decade. Blended finance will need to be part of the solution which was a key theme stemming from our thought leadership piece on [Tapping into the power of blended finance](#).
- Continued investment in hyperscale digital infrastructure and generative AI. These were very much front of mind for CEO's based on the responses to the **27th PwC Annual Global CEO Survey**. This should drive more opportunity for Infrastructure investors.





- Market participants indicate that the denominator effect from overweighting of infrastructure holdings in portfolio allocations is indeed temporary, with investors generally taking a long-term view on infrastructure investments. This view has been supported by a resurgence of the US equity markets during 2023 (+24%) after a dismal showing in 2022 (-18%);
- Interest rate rises have tapered off and are forecast to start to come down in key markets from the back end of 2024, noting central banks are exercising caution on pulling the trigger. We also note that the increase in interest rates from the Bank of Japan for the first time in 17 years has been aimed at spurring economic activity in Japan; and
- A record level of global infrastructure dry powder of US\$339 billion at Jan-24.<sup>3</sup>

What does this all mean for the Australian market – whilst some of the above global themes will also play out in Australia, there are other factors to consider. Stay tuned for the release of our M&A Outlook – Infrastructure in focus during 2024!

<sup>3</sup> Preqin Pro



# ESG update – Nature to follow climate's lead

Since our last newsletter, the Nature Repair Bill made its passage through parliament in December 2023, creating Australia's framework for a world-first voluntary Nature Repair Market. While it provides landholders with the opportunity to earn both biodiversity certificates and carbon credits on projects, interestingly the 'biodiversity credits' cannot be used to offset environmental impacts of other developments. This is a contrast to recent developments in the UK, introducing legislation that requires developers to demonstrate a 10 percent 'biodiversity net gain' or otherwise purchase offset credits. Australia's rules may limit the commercial attractiveness of the scheme in the face of climate focused market and regulatory pressure, and an ever-maturing carbon market rife with opportunities for infrastructure investors.

However, beyond the commercial lens, we should not ignore that infrastructure developments present one of the greatest threats to nature. Globally, at least 80% of sites identified as key to biodiversity house infrastructure such as roads and even 'climate positive' renewables – a percentage only set to increase. At the same time, nature is critical to the broader decarbonisation agenda, with the restoration of habitats across the globe a potential key to unlocking 30-40% reduction in CO2 emissions.







As Australian infrastructure assets continue to attract attention on a global scale, including from EU investors with evolving ESG mandates, we expect nature related risks and opportunities to increasingly sit alongside climate as a core investment consideration. PwC analysis shows that construction is one of five industries where 100% of economic value from direct operations and 63% from supply chains is highly dependent on nature. From a value lens, a growing number of dedicated 'natural capital' funds are promoting multi-faceted strategies to drive decarbonisation, biodiversity restoration and other environmental outcomes – with forestry and agricultural investments a common focus.

Importantly, amongst the recent global momentum to standardise climate-related financial disclosures, the Taskforce for Nature related Financial Disclosure (TNFD) recommendations were released in September 2023. There is talk that these will soon be integrated into the IFRS-led International Sustainability Standards Board (ISSB), and eventually follow the same path as climate reporting, which is now being mandated in Australia and other countries. With increasing formality and pressure to come from these developments, infrastructure investors should proactively assess each investment in the portfolio on measures of biodiversity and nature strategies, planning and design alternatives, and biodiversity management plans, not only to safeguard investments from regulatory and reputational risks, but ultimately with a view to deliver a positive impact on nature.





# In focus – Is it time to consider Agriculture a core plus asset class?

## Evolution of infrastructure investments in the Australian agriculture sector – what has changed?

Historically infrastructure as an asset class was very much focussed on ‘core’ physical assets – think roads, ports, airports, networks. Over recent years, the asset class has expanded further up the risk/return curve into ‘core +’ assets that have essential service characteristics, and ideally contracted cashflows to provide infra-like characteristics, albeit often exposed to specific risks requiring consideration. Are these specific risks of the agricultural sector insurmountable or could it be the next ‘infrastructure’ investment opportunity?

To date traditional infrastructure investors have largely focussed on sale and leaseback structures in the Australian agricultural sector where investments are underpinned by land and water assets, capital appreciation and stable rental returns without direct exposure to operational or agricultural risk. These risks include seasonal conditions, natural disasters, fluctuations in commodity prices and exposure to markets and customer dynamics.

Sale and leaseback structures provide a passive investment, where yields are correlated to the underlying investment such that:

- Less intensive operations such as cropping and grazing enterprises typically attract lower yields.
- More capital-intensive sectors including post farmgate assets or horticulture assets (permanent plantings such as vineyards, almonds, citrus and forestry) require a higher level of return.

Landlords get comfortable around counterparty risk by partnering with a blue-chip tenant and structuring a triple net lease with tailored rental yield terms, long lease periods with options and clearly defined capital expenditure treatment parameters.





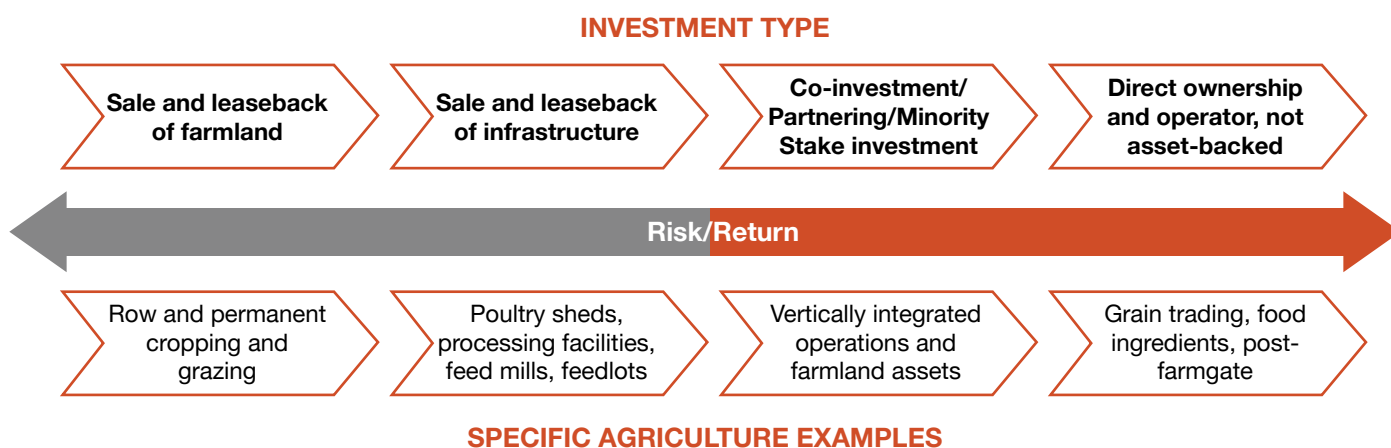


#### Recent sale and leaseback examples:

- Charter Hall's acquisition to lease of ASX-listed Inghams' poultry property portfolio, including 27 properties with hatcheries, feed mills and breeder farms.
- ASX-listed REIT Vitalharvest's acquisition to lease 7 farms from Costa Group, including citrus orchards and berry farms. These property assets and leases have subsequently been acquired by Macquarie Infrastructure and Real Assets.
- Future Fund's investment in SA Forestry who have \$600m+ of forestry assets in South Australia via US timber investment manager The Campbell Group.

While sale and leaseback transactions in the agri sector remain common, there has been increased appetite from core plus infrastructure firms to invest beyond landlord risk into vertically integrated agribusinesses with a greater exposure to operational and agricultural risk. Growing interest has been driven by opportunities and operational risks in the sector which drive higher long term returns as well as an increase in energy transition and ESG focussed investments.

#### Core plus infrastructure investment in the Australian agriculture sector







The underlying fundamentals of Australian agriculture are favourable. With capital to deploy, investors are recognising the benefits and attractive returns that agriculture offers (generally uncorrelated to financial assets). Infrastructure investors are becoming increasingly comfortable with the operational and agricultural risks involved with these investments such as commodity risk and seasonal/weather risks given other similar thematic and characteristics to traditional infrastructure investments as follows:

- **Strong asset backing with expected capital appreciation**, with real asset values in agriculture proving to be resilient, with 20-year CAGR returns on farmland of 8.5%.<sup>4</sup>
- **Positive macro thematics** including strong demand for agricultural commodities, staple consumer foods and value-added food products which is growing in line with population growth and changing diets in developing countries.
- **High demand and long-term customers** providing steady cash flows and are commonly underpinned by long term offtake agreements with a blue-chip customer base.
- **Blue-chip operators** are growing in prevalence, including asset and farm managers, providing confidence to infrastructure capital sources with limited to no agricultural experience.
- **Long term investment horizons and margin control** assist with mitigating risks through adopting strategies such as geographic diversification, downstream investments/vertical integration and 20+ year investments through-the-cycle of temporary weather and commodity risk volatility.
- **Growing ESG opportunities** in the agriculture sector, including monetising carbon, nature-positive land management efforts and diversification into renewable energy investments.
- **High barriers to entry** given the scale, complex supply chains, significant upfront capital and access to suitable land and water.

<sup>4</sup> Rural Bank 2023





## Recent examples and what to expect for the year ahead?

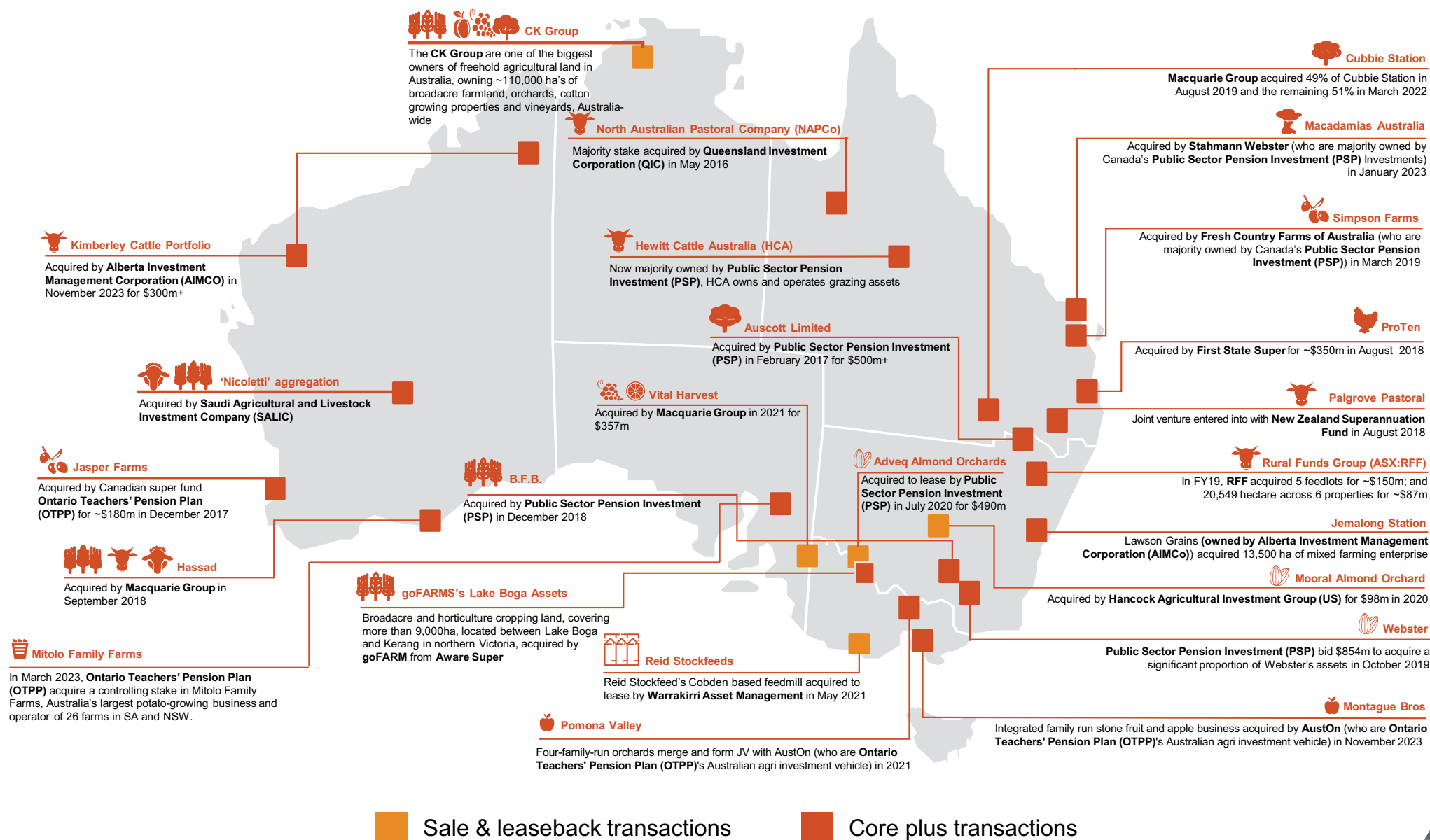
Many of the core plus infrastructure investments in Australian agriculture more recently are from North American pension funds, with notable examples including:

- Ontario Teachers' Pension Plan's (OTPP) acquisition of a majority stake in one of Australia's potato and onion producers Mitolo Family Farms in 2023, including over 50,000 ha of farmland and 2x processing facilities representing an asset-backed investment into a consumer staple business.
- Alberta Investment Management Corporation's (AIMCo) acquisition into large scale northern Australian Kimberley Cattle Portfolio comprising almost 3 million ha, offering decarbonising opportunities and renewable energy options in addition to the core operational business.
- Macadamia's Australia sold their Australian nut business including over 200,000 trees and a processing plant to Canadian based PSP Investments' (PSP) nut business Stahmann Webster in 2023 for over \$100m.
- Ellerslie Free Range Farms (owner of Sunny Queen), one of Australia's largest egg producers, has recently entered an agreement to sell majority ownership to PSP for ~\$180m.

Sale and leaseback is here to stay, however, there is demonstrated growth into core plus investments from infrastructure and institutional investors.



## Selected Australian Agri M&A transactions



Source: Publicly available newspaper articles and Company Websites





# Deals Strategy and Operations – Demystifying carve-outs – How to create value in infrastructure transactions

Recent trends have highlighted corporates looking to recycle infrastructure or infra-like assets as part of their M&A transactions. An example of this is the Telco sector in which there have been a number of transactions where the infrastructure assets (i.e. towers and fibre) have been separated to be packaged up and divested to raise capital to deploy towards investing in other technologies.

Executing a carve-out transaction is complex, below we have outlined some of the common pitfalls which often results in carve-out transactions not delivering the full value intended:

- **Clearly define the transaction perimeter:**  
The dedicated assets will have been clearly identified that are in the perimeter. However, typically this does not extend to corporate and shared functions/assets which are often being agreed during or post diligence leading to potential shifts in value between parties or complexity which needs to be resolved ahead of completion.
- **Align on separation fundamentals:**  
Often it is not clear on what the planning activities are aiming to solve for (i.e. cost minimisation or speed of separation) and how costs and risks will be shared and managed. Early alignment on the separation fundamentals will help fasttrack planning activities and remove uncertainty associated with the separation.



- **Prepare a clear plan for the target state:**  
Detailed planning typically occurs post signing with the sign to close period focusing on transitional services required for Day 1 and the first 100 days post Day 1 focussed on separation execution planning. Building a separation blueprint that can be aligned between both parties around a clear target operating model, with a defined end state and transition plan will enable both parties to identify risks and define expectations prior to deal signing.
- **Identify the full value potential:**  
Identify and analyse the opportunities for growth in adjacent markets or sectors as well as potential cost savings as part of your target end-state. In our experience a separation event can provide the catalyst for challenging operational assumptions and realising efficiencies in areas such as supply chain, back-office and technology. Gather the right data and analysis to support the potential initiatives to ensure no value is left on the table.

Whilst carve-out transactions can be more complex than a standalone business sale potential bidders can de-risk their investment through careful planning and due diligence. There should be three key focus areas for your separation analysis during the due diligence phase to ensure there are no surprises following deal completion.

1. Certainty over ongoing and one-off separation costs.
2. Deliverability of the separation plans without business disruption.
3. Efficiency of the standalone operating model and proposed transition plan.





Outlined below are some of the key questions you should address to ensure certainty, deliverability and efficiency of the separation process:

#### **Certainty:**

- Does the proposed standalone operating model deliver all required capabilities?
- Are there sufficient costs to support the proposed operating model?
- What are the key operating model changes required in the standalone state?
- What capabilities are existing and will transfer versus activities that need to be newly established?
- What are the one-off costs required to achieve separation? What is the split between the buyer's account and seller's account?
- Does the transferring perimeter or Transitional Services provide the necessary capabilities to ensure business continuity on Day 1?
- What are the separation principles you will adhere to as part of separation planning?
- How will systems, operational sites be separated (where required)?
- What activities is the seller/buyer responsible for?
- Is the proposed TSA duration sufficient to achieve separation?
- Who controls the overall planning activity between parties to ensure dependencies and timelines are aligned (i.e. technology establishment vs. TSA migration)?

#### **Efficiency:**

- What are the future value creation opportunities? How will they impact/be impacted by the separation? Are there value creation opportunities that are a competitive advantage compared to other bidders (i.e. Synergies)
- Are there alternative separation approaches that could minimise one-off costs?
- Are there activities that could be accelerated to fastrack separation?

#### **Deliverability:**

- How will the perimeter be operationalised on Day 1 to maintain business continuity?
- What services are provided under TSA/ reverse TSA?
- What activities does a buyer need to absorb or stand-up ahead of Day 1?
- What is the transition roadmap to deliver separation?

Carve-out transactions are inherently more complex than the sale of a standalone business, however they do provide an opportunity to create value as long as you have asked the key questions early and have a clear plan to achieve separation.

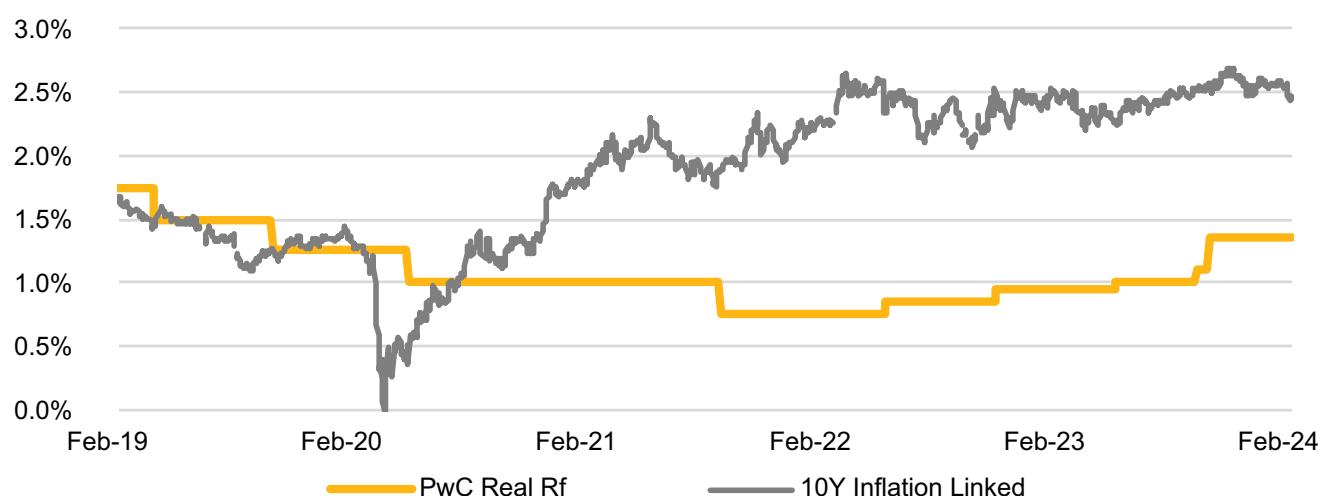




# How are market indicators driving our views on the Australian long-run nominal risk free rate?

Our assessed nominal Australian risk-free rate has decreased by 5bps from December 2023 to 3.95%, driven by a reduced long-term inflation estimate of 2.60% from 2.65% and a stable real risk-free rate of 1.35%.

## Summary of real risk-free rate estimates



Source: Bloomberg, PwC Analysis

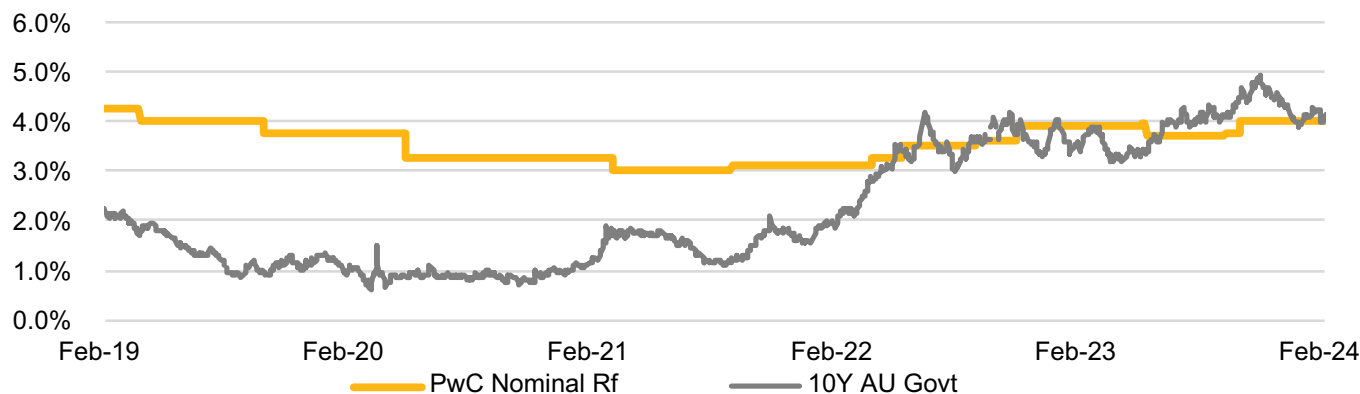
In the past quarter, central banks globally, including the Reserve Bank of Australia (RBA), have paused the significant interest rate hikes implemented over the prior years to bring inflation under control. As inflation begins to stabilise, concerns have shifted toward the possibility of recessions and an economic slowdown, driven by rising unemployment, fewer job vacancies, and subdued retail sales during the holiday season.

The most recent Consumer Price Index (CPI) indicator figures released in February 2024 indicate a sustained decline, with a year-over-year price increase of 3.4% to January 2024, falling slightly below economist expectations. The diminishing inflationary pressure and the softened economic outlook are paving the way for potential rate reductions by the RBA in upcoming quarters.





## Summary of nominal risk-free rate estimates

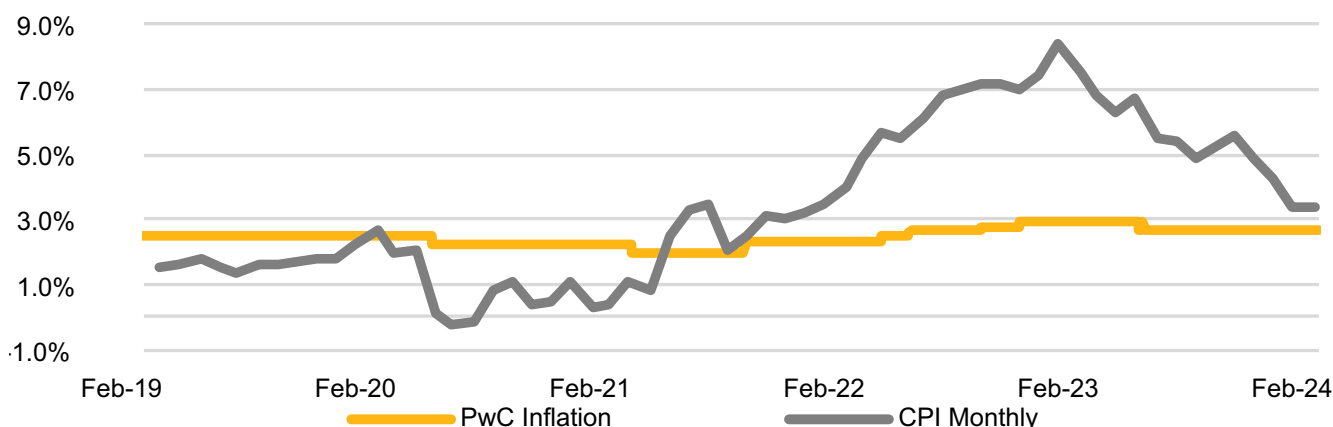


Source: Bloomberg, PwC Analysis

Market responses have been robust during the quarter, with the 30 Day Cash Rate Futures pricing in approximately a 5% to 15% chance of a policy rate cut to 4.10% as early as March 2024. Concurrently, the equity market has rallied, recording successive all-time highs for the ASX, buoyed by

expectations of impending rate cuts. Despite a slight delay in company earnings updates and ongoing market volatility, this equity surge has exerted significant pressure on expected market returns over the last quarter, with the average implied nominal earnings yield dropping to levels not seen since early 2023.

## Summary of inflation estimates



Source: Bloomberg, PwC Analysis







Leading up to March 2024, the market relinquished some of its gains as investors tempered their expectations for swift and substantial rate cuts amid some lingering concerns on inflation. Nonetheless, current data casts doubt on the ‘higher-for-longer’ rate scenario that dominated conversations in 2023. Statements from the RBA and other global central banks hint at a shift in policy direction that, just a few months ago, was not entirely unanticipated.

Against this backdrop, in evaluating our estimate of the risk-free rate for valuations as at March 2024, we have continued to focus on a long term position, taking into consideration a range of analysis and market observations. Consequently, we have slightly reduced our view on risk free rates over the last quarter driven by a reduction in inflation estimates. While implied yields from equity market indices may suggest a slightly lower real return, observations from the fixed income markets continue to support our view on the real rate of return.







# Changes to Australia's thin capitalisation rules

The Federal Parliament has now passed the long-awaited laws to introduce major reforms to Australia's thin capitalisation regime. These reforms were first announced in October 2022 and following two separate Senate committee enquiries and a number of amendments, the bill passed both Houses of Parliament on 27 March 2024.

The new regime will introduce:

1. new interest limitation rules, to apply to income years commencing on or after 1 July 2023; and
2. debt deduction creation rules, to apply to income years commencing on or after 1 July 2024. The debt deduction creation rules can affect debt deductions arising from arrangements entered into both before and after the commencement date.

The features of the new regime are consistent with the additional amendments announced by the Government in November 2023, which provided for:

- the ability to pass up excess tax EBITDA to certain companies, partnerships, and managed investment trusts, in addition to unit trusts (as previously proposed), where the fixed ratio test is used;
- broadening the third-party debt test by allowing various exemptions to the prohibition on credit support rights and allowing for situations where the lender has recourse to 'minor or insignificant' ineligible assets;
- a deferral of the start date for the debt deduction creation rules until income years commencing on or after 1 July 2024 for all arrangements; and
- a significant narrowing of the scope of arrangements that may fall within scope of the debt deduction creation rules.

There was also a last-minute amendment to the final Bill, to exclude Australian plantation forestry entities from the new thin capitalisation regime. Those entities will instead continue to apply the thin capitalisation provisions as in force immediately before this Bill takes effect.

PwC has prepared the following tax alert which provides an overview of the final rules that will officially become law when the Bill receives Royal Assent:

[Thin Capitalisation Tax Alert 2024](#)

# Key contacts – PwC Australia

If you would like to discuss the above topics in more detail, our dedicated deals infrastructure teams would be pleased to assist.

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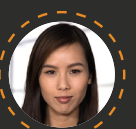


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