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Trends

'Double-digit returns are behind us', claims EDHECinfra

It's not just 'a wall of capital' chasing too few deals that has driven up infrastructure valuations in the past 15 years, but other systematic factors as well, the research institute says in its latest study.

By **Kalliope Gourntis** - 18 hours ago

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The price increase infrastructure assets have experienced in the past decade are not a 'bubble' but the result of a slow price discovery, EDHECinfra, a Singapore-based research institute claimed in a recent study.

"Infrastructure is a new asset class; numerous deals had to happen before buyers and sellers discovered a 'fair price'," Sarah Tame, associate director, EDHECinfra, told Infrastructure Investor. "It is also important to note that valuations did not just increase rapidly due to a wall of cash chasing assets, but rather prices evolved to reflect the preferences of investors taking major risk factors into account," she said.

According to the study, those six systematic risk factors are: size (larger assets are found to have lower prices); leverage (highly-leveraged assets are priced lower); growth (the greater the growth potential, the higher the price); term spread (a larger difference between long- and short-term rates lowers valuations); and profit (higher profits tend to increase prices).

"Our results show that despite the evolution of investor preferences, systematic risk factors mostly continued to explain prices over that [15-year] period,

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indicating that valuations remained, on average, rational and fair,” EDHECinfra stated in its report.

The paper concludes that these risk factors will continue to shape valuations but notes that prices have begun to stabilise, as has the price-discovery process.

Still, “the days of double-digit returns for infrastructure are behind us,” Tame said. “Investors should not simply be looking at absolute return targets, they should be thinking about a risk-adjusted return.”

Using the EDHECinfra database, which is representative of the investable market for infrastructure, the institute observed 680 secondary market transactions between 1995 and 2017. These observable transaction prices were used as a starting point. “We used a factor model to compute ‘shadow prices’ for all the assets that did not trade over the past 15 years,” Tame explained, noting that the result was more than 6,000 shadow prices.

“This is the really unique thing about this **study**” she continued. “In the past, people have just looked at observed valuations and tried to find trends. But private infrastructure is an illiquid market and assets do not trade often. As a result, observable transaction prices are limited and are not representative of the investable market,” Tame said.

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