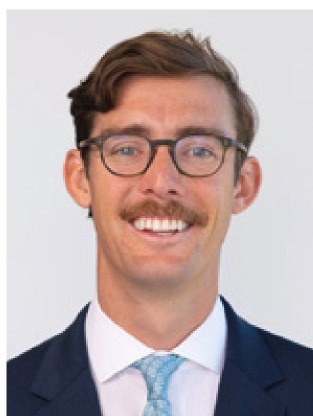
KEYNOTE INTERVIEW

Transport's 'robust set of opportunities'



Stonepeak's James Wyper discusses the encouraging backdrop for transport and logistics investing in North America resulting from strong economic fundamentals and favourable government policies

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Stonepeak manages nearly $60 billion of assets globally across three main areas of infrastructure investment: energy and the energy transition, communications and digital infrastructure, and transport and logistics. Each of these sectors generally represents anywhere from 20-40 percent of the firm's total portfolio at any one time.

The firm's transport and logistics sector is led by James Wyper, senior managing director. While Stonepeak has offices in Asia-Pacific and London, the US remains a key focus area of investment activity, including in transport and logistics. As Wyper says: "The majority of our infrastructure assets and personnel are in North America and we continue to see a robust set of opportunities to deploy capital in the region."

Q Why are you so optimistic on the investment outlook for the US?

There are several built-in advantages to investing in North America and in the US specifically. Currently, conditions in the US, including long-term demographics, are more favourable than most other major markets.

For example, the US population is expected to continue to grow steadily over the coming 20-plus years, both organically and from net migration, in contrast to many other major developed economies, where populations are presently in or expected to decline. Additionally, the US economy is considerably richer and more dynamic than developed markets in the rest of the world, a gap that is, in most instances, still growing.

In addition, the scale of our natural resource endowment – and the degree of self-sufficiency it provides – both helps insulate the US economy

against global macro shocks and trade disruptions while also advantaging local industry input and transportation costs. The US is one of the only major economies that is well established in both food and energy security, and represents a critical source of global supply for both types of commodities. Meanwhile, the rest of the developed world relies on the US for both those and other key exports, including technology, energy, capital and protection.

Short-term considerations are also positive. As we move into more difficult global macroeconomic conditions, the strength and reserve currency status of the dollar provide tremendous flexibility, which along with the quality, depth and sophistication of our capital markets, have led to a general economic outlook stronger in both absolute and relative terms. To be sure there are interesting pockets of opportunity in Europe and Asia that we are following closely, and it is true the macroeconomic dynamics in the US are complex, but overall we view the current outlook for North America as more positive on a relative basis.

And then on top of all this, and of special interest to private investors, is the scale of the infrastructure funding gap that exists in the US compared to other developed markets.

Q How significant is the US funding gap?

The US approach to infrastructure spending for the better part of the last century has been characterised by underinvestment due to its complex underlying ownership, governance and funding structures combined with a reluctance historically to embrace private investment. Many infrastructure assets are significant 'employment-engines', and altering them has political and broader stakeholder impact. This has in some ways discouraged state and local legislators from fully exploring the potential of private investment.

We have now reached a crucial inflexion point. US public infrastructure is ranked outside of the top 10 globally by the World Economic Forum and receives a D+ rating by the US Army Corps of Engineers. Nearly 10 percent of US bridges are considered structurally deficient, and close to half the country's public road network is underperforming, creating massive traffic disruptions. There is a real danger that unless action is taken, the poor quality of US infrastructure will have a real impact on the country's global competitiveness.

It is estimated that there is a $2.6 trillion infrastructure funding gap in the US in order to meet total infrastructure needs by 2029. Even with the significant amounts of money being spent and allocated currently, we believe that there is still a shortfall that amounts to approximately $1.5 trillion to $2 trillion in spending compared to what is actually needed. It is really demanding to do 80 years of catch up in just 10 years of investment.

Q Is private capital the solution to the infrastructure funding gap?

To close the funding gap, the US must increase infrastructure investment from a mix of both the government and the private sector from 2.5 to 3.5 percent of US GDP, just by 2025. We believe the potential for further investment across key infrastructure sectors including energy, digital infrastructure, and transport and logistics remains enormous, and fortunately we have significant experience at a senior level with both ownership of these types of assets as well as the complex funding and governance dynamics involved.

Happily, we are seeing significant efforts on the part of the federal government to encourage investment in various sectors within infrastructure. There have been three major pieces of legislation: the Infrastructure Investment and Jobs Act, the Inflation Reduction Act and the CHIPS Act. Collectively these are introducing $2 trillion of new federal spending to bolster US infrastructure policy and bridge the funding gap.

Rejuvenating US infrastructure provides significant opportunities across a broad range of investments, including highways, bridges, tunnels, ports and airports. This is long overdue and comes in addition to the opportunities for investors from the developing trends in supply chains and distribution.

Q Can you expand on the investment opportunities and trends you are seeing across supply chains and distribution businesses?

Manufacturers, distributors and retailers have all re-evaluated their supply chains in the wake of covid and are actively seeking to digest learnings from the disruptions experienced. Covid exposed a global over-reliance on certain regions for manufacturing.

The lack of access to Chinese-manufactured products, in large part due to the zero-covid policy and consequent shutdowns, was a shocking and unprecedented disruption. In response, companies are now more motivated to diversify their supply chains, pursuing an aggressive rotation towards near-shoring and friendshoring.

These shifts are unlocking new, compelling opportunities for investment as well as changing the way we think about or value existing infrastructure. First order impacts, for example the need for new warehousing and logistics buildout to support the build-out of new manufacturing capacity, are a major area of deal-sourcing focus. But there are two sides to every coin, and this same shift may disadvantage other assets, and we are focused on making sure our underwriting encompasses a

holistic and consistent worldview, both for our domestic as well as international investments.

One specific example of this transition underway is in the semiconductor industry. While the US manufactured close to 40 percent of the global supply of semiconductors in 1990, this had fallen to barely 10 percent by 2020. Both supply chain disruptions during covid, as well as an increasingly concerning geopolitical backdrop, made clear that this was an unsustainable dynamic from both a national security and economic perspective.

The CHIPS Act, announced in 2022, has been a fantastic boost for business in this ecosystem with hundreds of billions of dollars of capital being provided to companies such as Intel, Micron and other semiconductor manufacturers to accelerate their chip production programmes. While many of these plans were already in place, the availability of government capital and support has dramatically brought forward their timelines.

We took note of this impending shift and last year acquired the leading provider of specialty warehousing and logistics capabilities to blue chip customers in the semiconductor space as they continue to ramp chip production.

Q Are there knock-on effects?

Absolutely. It is important for investors to understand the second and third degree effects of these supply chain and distribution shifts. If the point of entry and volume of goods being distributed in a particular market changes, especially at this level of magnitude, you are also creating new and different logistics demands further down the chain.

Trucking, rail and intermodal networks will need to be bolstered to handle the global supply chain shift into regional hubs and to fully capture the upside of this evolution. The significant investment programmes from US government and corporates are accelerating this trend and we have sought to invest in the businesses that stand to benefit from it.

Security and reliability concerns come on top of other important supply chain considerations. Across our portfolio we are seeing first-hand an increased focus on developing resilient and flexible supply chains, capturing efficiencies through technology solutions and establishing new infrastructure to handle shifting trends in both the supply and demand side of the equation.

Q How are e-commerce and digitalisation contributing to significant changes in operations across the sector?

With the rise of e-commerce demand, there is an increasing emphasis on 'last mile' distribution. Speed of delivery is one of the most crucial elements for e-commerce today and, as the proportion of retail sales in the US has more than doubled in this sector, it has been one of the key drivers and differentiators of retailer success.

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For logistics investors this has meant enabling a transition away from a network where distributors might have one or several enormous warehouses, mid-continent, to a series of more regional or local hubs, typically proximate to consumption. The other major and parallel theme is digitalisation, including the ongoing evolution and optimisation of transportation through technology and AI.

Digitisation delivers better supply and demand planning, route optimisation, vessel sharing, improved loading and unloading of cargo, and real-time shipment tracking. We have seen the significant benefits of deploying precision scheduling in railroads and how this can dramatically improve performance. We believe upgrading roadways with smart tech represents a $650 billion investment opportunity by 2025.

The scope for digitalisation in logistics is also frankly enormous, given the relatively unsophisticated operating landscape today. A lot of logistics businesses are still family run. Something like 40 percent of all billing is still done by paper and, unbelievably, 50 percent of supply chain transactions are still monitored on excel spreadsheets. The use of up-to-date IT systems and dashboards can more than double the speed at which transactions happen, and significantly reduce snarl-ups in delivery systems.

Likewise, in cold storage the number one expenditure is labour, closely followed by operating expenses. We find there are many examples of low-hanging fruit, such as optimising energy usage by switching to purchasing at off-peak times, cooling a facility during the night and then perhaps allowing temperatures to drift higher during the working day. Depending on the business, this can save up to 25 percent on energy bills.

The historic high-cost model in logistics can lead to considerable expense when things go wrong, but also to considerable savings when things are put right. ■