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INVESTOR WATCH: CANADA'S IMCO PREPARES TO FLEX MUSCLES IN ONTARIO

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Institutional investor the Investment Management Corporation of Ontario (IMCO) wants to grow its client base and consolidate 16 fund manager relationships within infrastructure. Can investing outside the Canadian market provide the right justification, asks Yuanqing Sun

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Author: Yuanqing Sun

The youngest Canadian institutional investor – Investment Management Corporation of Ontario (IMCO) – is also one of Canada's largest institutional investors, managing CAD 63.3bn (USD 47.4bn) in AUM on behalf of its clients.

But with roughly 90 potential clients to go after in Ontario, the nascent manager is seeing as much challenge as potential in the fundraising market.

As the infrastructure market gets more competitive, IMCO is attempting to strike a balance between internal capability and external partnerships, while at the same time transforming the portfolios that it inherited from its clients.

"That is what is required in this world," says chief investment officer Jean Michel, "where it's going to be very complicated to make money over the next 10 to 20 years, considering the amount of competition that we all have to deal with in any transaction."

Michel joined IMCO in 2018 after holding senior positions at Air Canada Pension Investments and Caisse de dépôt et placement du Québec (CDPQ).

"I'm not just talking about a core asset in the US, but also in Brazil or even India. There are multiple players that can bid on almost anything. Being able to get the best out of an internal team and external partners is going to be very critical."

Selecting partners

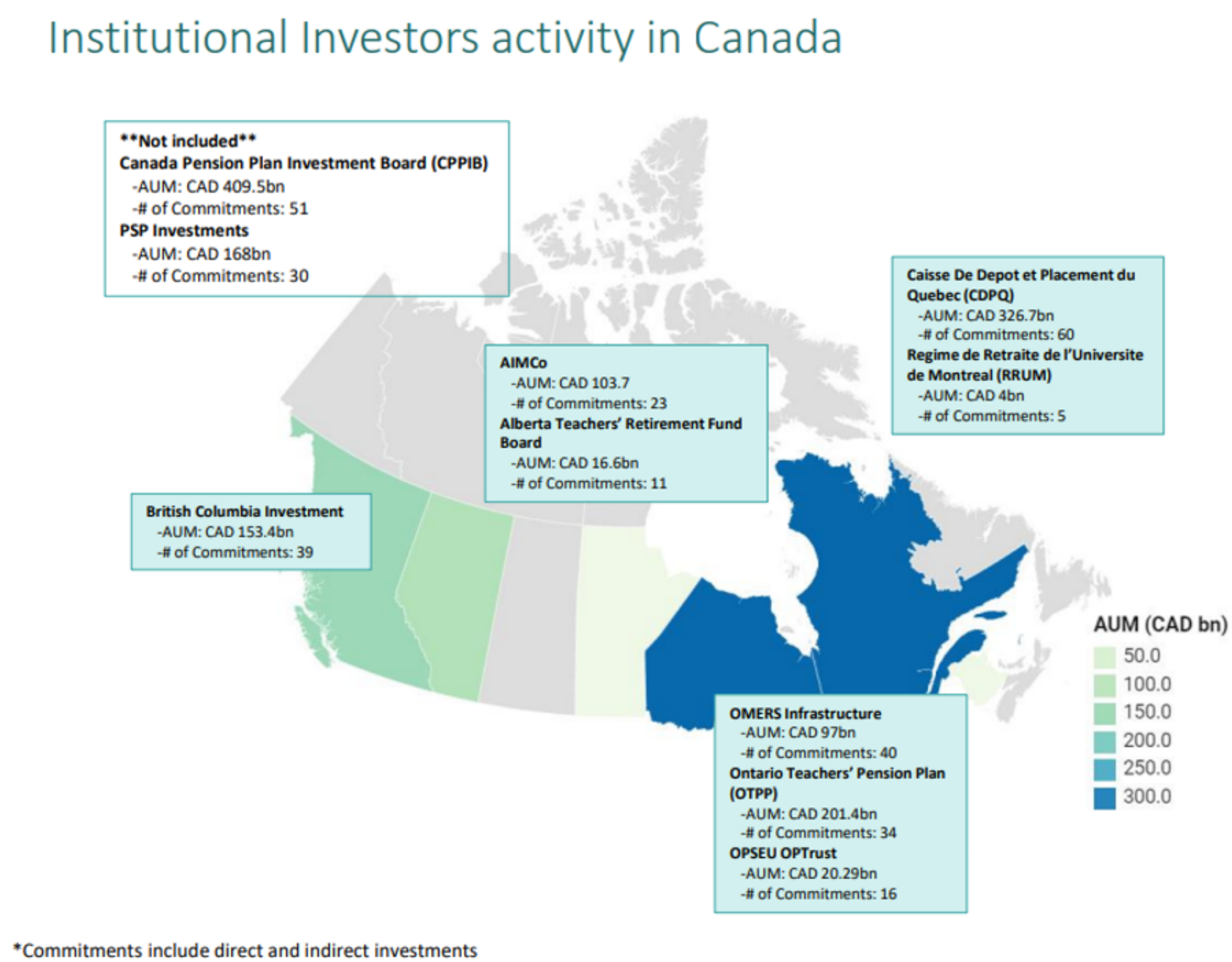
Created by the Ontario government as an independent firm in 2016, IMCO has been designed to manage assets for public sector pensions and investment funds in Ontario, although they are not obligated to participate.

IMCO now has two clients: Ontario Pension Board and the Workplace Safety and Insurance Board. It eventually wants to secure around a third of Ontario's 90 potential clients, which have around CAD 120bn in total assets, in the next six to seven years. Potential clients include government agencies, corporations controlled by the Ontario government, universities and municipalities.

Michel anticipates at least one more client within the next quarter and there are a few more prospects by the end of 2020 with negotiations underway, he adds.

Similar to its Canadian peers CDPQ, Alberta Investment Management Corporation (AIMCo) and British Columbia Investment Management Corporation (BCI), IMCO seeks to reduce management costs for its clients by investing in greater scale through asset pooling.

But instead of a typical fund program, IMCO wants to limit itself to a few select partners.



Source: Inframation Deals

IMCO currently has 16 existing fund manager relationships within infrastructure, but it plans to consolidate those to five or six managers. Two or three will be with existing managers, and the rest will be new funds, says Michel.

Consolidating manager relationships has been a way to save management fees for institutional investors including CalSTRS and Teacher Retirement System of Texas over the past year.

Last year, IMCO committed USD 350m to AMP Capital Global Infrastructure Fund II and USD 300m to Brookfield Infra Fund IV.

Both Brookfield and AMP have offered IMCO a significant co-investment in the past and will continue as fund partners bringing co-investment and direct investments opportunities. IMCO will also consider buying assets from the funds when they sell, says Michel.

For its new managers, IMCO will pursue a mix of core and value-add or development or even greenfield projects.

"The fund investment will focus more on what is complicated: the value-add, the greenfield and the emerging market component of it. Everything that is core in the more developed world, we can do by ourselves. It doesn't really make sense to pay significant amounts of fees on things that expect returns around 6% or 7%," says Michel.

"In this world of low expected returns, you need to manage carefully. The discussion of internal versus external makes a lot of sense as cost is a big portion of this discussion. If you want to reduce costs by 10 basis points, which doesn't sound like much, you need to work really hard to get it."

Eventually, around 40% of the total infrastructure assets will be in fund investment and the remaining 60% is going to be a mix of co-investment and direct investments, he adds.

At the same time, IMCO is looking to build the internal capability of the infrastructure team: it now has nine people and will have another four before year end, with an aim for 20 to 25 people eventually, says Michel.

The legacy portfolio

A major challenge for IMCO will be to transform the clients' portfolios on both the public and private side.

For infrastructure, IMCO is recommending clients increase their infrastructure allocation to a long-term target of between 12 and 15%. Actual allocation stands at 7% of IMCO's overall portfolio with CAD 5.6bn infrastructure assets under management as of 31 December 2018.

In comparison, CDPQ has an 8.17% allocation in infrastructure, while BCI has an 8.4% allocation, according to *Inframation Deals*.

While IMCO has full discretion on the asset management, asset allocation remains the responsibility of its clients.

"This year we have sold more assets that we have acquired assets," says Michel. "We're re-analyzing who's going to be our partners."

In 2019, IMCO sold its 9.99% stake in Koole Terminals (an international storage and transport company) to JP Morgan Infrastructure Investment Fund, for a combinations of reasons including the program's overall exposure to energy assets, the team's view of the long-term fundamentals of hydrocarbon fuel demand and storage in Europe and underperformance on the execution of Koole's business plan, Michel says.

The decision was also related to a strategic shift away from minority passive holdings, he adds.

Also last year, IMCO (alongside investing partner I Squared Capital) sold an undisclosed stake in Cube Hydro – owner and operator of hydropower facilities located in the US – to Ontario Power Generation, after what was said to be a strong operating performance. The terms of the deal were not disclosed.

Select 2019 & 2018 Deals

Year	Country	Deal type	Asset	Deal description
2019	Europe	Divestment	Koole Terminals	IMCO sold its 9.99% stake in Koole Terminals, an international storage and transport company, to JP Morgan Infrastructure Investment Fund.
2019	US	Divestment	Cube Hydro	IMCO (alongside investing partner I Squared Capital) sold an undisclosed stake in Cube Hydro – owner and operator of hydropower facilities located in the US – to Ontario Power Generation.
2018	UK	Investment	Bioenergy Infrastructure Group	Through a co-investment with a U.K.-based infrastructure manager, IMCO acquired an interest in Bioenergy Infrastructure Group, a U.K.-based energy-from-waste aggregation platform.
2018	Europe	Investment	euNetworks	Through a co-investment with a U.S.-based infrastructure manager, IMCO acquired an interest in euNetworks, a leading pan-European fibre network provider.
2018	Canada	Investment	Canadian Hydroelectric Portfolio	IMCO led a consortium of buyers that acquired a 25-percent stake in a 413-megawatt Canadian hydroelectric portfolio from Brookfield Renewable Partners.
2018	Spain	Investment	CLH Group	IMCO increased its stake in Spanish refined oil logistics operator CLH Group through a follow-on investment alongside another large European institutional investor.

Source: IMCO

Global plans

While Canada will always be the backyard for IMCO, US and Europe, especially the UK, continue to present significant opportunities for the investor, says Michel.

In 2018, IMCO acquired stakes in Bioenergy Infrastructure Group (a UK-based energy-from-waste aggregation platform) and euNetworks (a leading pan-European fibre network provider). It also led a consortium of buyers that acquired a 25% stake in a 413 MW Canadian hydroelectric portfolio from Brookfield Renewable Partners.

At the same time, Canada's P3 market had a slower year in 2019 due to political changes at the provincial level and the delay of the release of the Infrastructure Ontario pipeline, as previously reported. The Canadian infrastructure market saw 85 deals reach financial close in 2019, only just up from 81 in 2018, while deal value dropped to USD 27.52bn from USD 35.25bn in 2018, according to *Inframation Deals*.

But long-term prospects remain optimistic with Canada Infrastructure Bank helping fuel the pipeline, says Jennifer Aument, president of Transurban North America, in a previous interview with *Inframation*.

At the same time, IMCO is looking to build a global portfolio with consideration for emerging markets.

“We're relatively keen on looking at things in Latin America, especially Chile and Brazil, where there are a lot of opportunities. And then we're going to see if India would be something for us.”

As of 31 December 2018, 52% of its infrastructure assets are in Europe and Middle East, 22% is in US, 14% is in Canada, 6% is in emerging markets and 5% is in Asia.

By way of comparison, IMCO's neighbor the Ontario Municipal Employees Retirement System's (OMERS) net assets increased to CAD 109bn in 2019, up from CAD 97bn in 2018. Infrastructure returned 8.7% in the year, compared with 10.6% in 2018. Infrastructure takes up 19% of the total fund, up from 18% in 2018. Ontario Teachers' Pension Plan (OTPP) had net assets of CAD 191.1bn as of 31 December 2018. Infrastructure was 9% of the total fund with a 8.8% return.

Comparison between Canadian institutional investors

Institutional Investor	AUM	Allocation to Infra
IMCO	CAD 63bn	7%
OMERS	CAD 109bn	19%
OTPP	CAD 201bn	9%
CDPQ	CAD 340bn	8%
BCI	CAD 153bn	8%
AIMCo	CAD 108bn	7.50%

Source: Inframation Deals

IMCO may catch-up quickly. Its AUM remains at around CAD 63bn but Michel says if it reaches its target of securing a third of Ontario's 90 clients in the next six or seven years and “you add that to what we have plus returns, we're probably between CAD 100bn to CAD 125bn in five years.”

IMCO will begin reporting returns in its 2020 annual report in April 2021.

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