The role of infrastructure small-caps in energy transition

Infrastructure has a key role to play in advancing sustainability and in the energy transition. According to Maciej Tarasiuk from Aberdeen Investments, the lower mid-market offers an attractive entry point for infrastructure investing, with lower competition, opportunities for active asset management, and potential for value growth at exit.

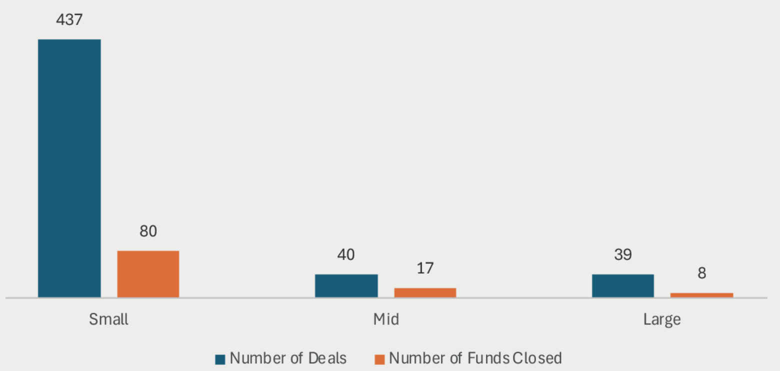
By *our editorial team*

What factors led you to focus on the lower mid-market infrastructure segment?

'This year marks the 10-year anniversary since our economic infrastructure team made its first investment, deploying capital in the Core/Core+ market. These initial investments were in a renewable energy generation platform and a regulated utility, both firmly within the lower mid-market definition. Despite significant capital being directed into the infrastructure market and many funds growing between vintages, we have remained disciplined in focusing on the smaller end of the market. This has been driven by the attractiveness of factors across the whole investment lifecycle. We estimate 1.7x more opportunities per infrastructure manager than in the mid and large cap market (see Figure 1). In addition, most opportunities are not suitable for competitive auction processes, which support more bespoke origination strategies. Through active asset management and collaboration with management teams, we aim to grow and corporatise our investments, including supporting strong sustainability implementation. Furthermore, growing our investments over time enables divestment into a liquid market, and benefits from multiple expansion linked to larger investment size. We see these factors as fundamental to achieving strong returns versus the Core/Core+ return profile. We have deployed circa €3 billion across 21 investments in Europe, where we estimate a 100–200bps positive spread versus large-cap strategies. Importantly, we also see less pressure to use high leverage, reducing overall risk linked to overburdened capital structures, an increasingly relevant factor in the current higher interest rate environment.'

FIGURE 1: LOWER COMPETITION[1]

European infrastructure transactions vs. funds closed (2023-2024)[2]



Source: Preqin, December 2024

With global ESG sentiment facing challenges, why does energy transition continue to be a critical part of your strategy?

'The world of sustainable investing is currently going through something of a reset. What we are seeing in Europe, with the Omnibus and wider focus on productivity, is a recognition that much of the regulatory focus on sustainable investment and disclosure, while well-intentioned, wasn't all that useful for investment decision-making. For us, as a direct investor in diversified lower mid-market infrastructure, sustainability has always been about understanding risks and value creation opportunities. Some of the most effective value creation levers in infrastructure relate to the energy transition, so they should be treated just like any other value drivers in the context of our investment objective. For us, despite the external noise created by the 'ESG backlash', nothing has changed. We take a rational approach to sustainability. Our sustainability framework and oversight span the full investment lifecycle, from sector selection and investment screening, to business planning and active asset management.'

Can financial objectives and ESG goals truly align for long-term success? Could you provide examples?

'Across our portfolio, we invest in energy, transportation, and digital infrastructure.

All these sectors have a strong sustainability and energy transition linkage, partly because the policy environment in Europe strongly supports outcomes like decarbonisation. This alignment means financial objectives and sustainability outcomes can often come together without compromise.

In 2024, our energy assets generated nearly 900 GWh of renewable electricity, avoiding 274k tonnes of CO_2—equivalent to taking 176k petrol cars off the road. Our district heat assets delivered 1.4 TWh of heat to over 88,000 customers from >90% renewable sources and are on track to be zero carbon by 2030. Despite focusing on small investments, these numbers show compelling outcomes from our strategy. What we find most interesting is how these stats are directly linked to value creation, even in the short term.

For instance, our district heating companies in Finland already use renewable biomass, and we are transitioning to non-combustion heat sources. In one case, we'll use waste heat from a local data centre, reducing biomass use by 50% and cutting energy generation costs by 25%. We've also started installing electric boilers across our assets, which take advantage of periods of abundant, cheap renewable electricity to generate and store heat for later use. This reduces production costs and supports greater use of renewable energy that might otherwise be curtailed.

Another example is our portfolio of railway rolling stock supporting over 50 million passenger journeys in 2024. By investing in modern trains with the latest technologies, we've ensured ongoing demand and reduced long-term residual value risk through improved operating costs. In particular, our Greater Anglia fleet in the UK has driven increased passenger numbers and revenues, while reducing maintenance costs thanks to the newer asset base. These financial improvements have helped Greater Anglia become one of only two UK operators returning a premium to the Government post-COVID-19. At the same time, by replacing diesel trains, we expect emissions reductions of at least 60%.'

How do infrastructure small-caps contribute to innovation and resilience in the energy transition and what advantages do they offer over larger-scale projects?

'The key advantage is smaller scale and diversification. This often translates into faster development timelines, streamlined planning processes and reduced risk of significant delays or budget overruns, which is common in large scale infrastructure projects. With over 80% of infrastructure investment opportunities in the small-cap space, there is significant opportunity to address the same energy transition challenge using a 'bite size' approach. To support the companies and lean on benefits of knowhow and resources of large-cap investors, we focus on working collaboratively with our management teams through a hands-on asset management model and leveraging our wider network to support joint initiatives. For example, we recently hosted a cybersecurity seminar to facilitate knowledge sharing and best practices across our portfolio, an initiative that underscores our commitment to enhancing the resilience of essential infrastructure assets.'

What key risks or misconceptions should investors consider when allocating to lower mid-market energy transition infrastructure?

'One of the most common misconceptions we encounter is that lower mid-market infrastructure investments are inherently riskier than large-cap investments. However, our portfolio experience suggests otherwise.

For instance, we hold several electricity distribution networks in Finland, where the regulatory framework is identical to that of large-cap assets. These investments often exhibit a lower overall risk profile, supported by more conservative capital structures, something we've achieved due to lower competition and reduced capital requirements.

Investing in smaller infrastructure companies often means working with leaner management teams. To succeed in this space, a hands-on, collaborative asset management approach is essential. By actively engaging with our portfolio companies and leveraging our broader network, we help drive long-term value creation.' ■

1 Small, mid & large cap funds defined as final close AUM of <€1bn, €1bn-€2.5bn, and >€2.5bn, respectively
2 Small, mid & large cap deals defined as enterprise value of <€500m, €500m-€1bn, and >€1bn, respectively

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PHOTO: ARCHIVE ABERDEEN INVESTMENTS

SUMMARY

The lower mid-market offers greater deal flow, less competition in auction processes, and opportunities to add value.

Despite ESG criticism, energy transition remains core for risk management and value creation.

Investments in energy, transport, and digital infrastructure show that financial goals and ESG can align, with measurable outcomes.

Small projects offer faster development, lower risks, and greater flexibility with active management.