Starlight Capital Global Infrastructure 2025 Outlook

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Infrastructure

In 2024, listed infrastructure produced exceptional returns. Easing monetary policy and the expectation of a dramatic increase in the need for power for generative AI were the largest drivers of performance. With the US election now in the rear-view mirror and Trump's pro-growth, pro-energy, anti-regulation, anti-immigration and anti-trade stance driving inflation expectations higher, we think infrastructure will see higher earnings growth expectations going forward, boosting valuations.

Some subsectors of infrastructure overcame tepid sentiment in 2023 to turn outright euphoric in 2024, with nuclear and gas power generation along with some well-located midstream networks being prime examples. Although last year's performance was strong, we don't believe the investment opportunity in infrastructure has been fully exhausted. On the contrary, we see the positive trends exhibited last year continuing to drive returns into 2025.

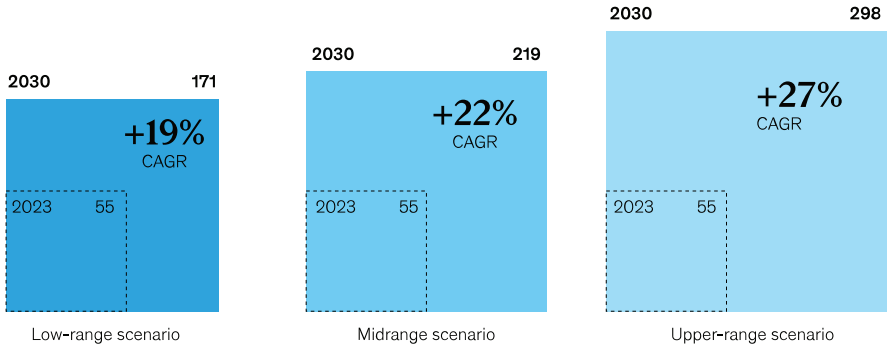
Infrastructure is more supply-constrained than almost any time in recent memory. Because of the rapid deployment of AI, power infrastructure will need to undergo a generational build-out at a rate not seen in at least 50 years. Congestion in urban areas is back at or above pre-COVID levels. The emerging trade themes of near-shoring and domestic manufacturing are likely to strain to freight rails, ports and other transport infrastructure.

AI has transformed the demand picture for Energy

The generative AI revolution has profoundly altered energy demand forecasts for the foreseeable future because it is a particularly power-hungry form of computing. The scale of generative AI data centres is immense, with single campuses often requiring hundreds of megawatts of power and billions of dollars in investment. McKinsey notes that average power densities have more than doubled in just two years and could nearly double again. Many more data centres will be needed as AI use-cases are adopted. The current trend suggests that global demand for data center capacity could rise at an annual rate of between 19 and 27 percent from 2023 through 2030 to reach an annual demand of 171 to 298 gigawatts (GW).

Global demand for data center capacity could more than triple by 2030

Demand for data center capacity[1], gigawatts



[1]Three scenarios showing the upper-, low-, and midrange estimates of demand, based on analysis of AI adoption trends; growth in shipments of different types of chips (application-specific integrated circuits, graphics processing units, etc) and associated power consumption; and the typical compute, storage, and network needs of AI workloads. Demand is measured by power consumption to reflect the number of servers a facility can house.

Source: McKinsey & Company.

The "Time to Power" Problem

This escalating demand presents a critical "time to power" challenge for the tech industry, which requires immediate and reliable energy solutions. This demand is straining local utilities to the point that they are turning away customers and extended their timelines for interconnection. In northern Virginia, the data centre capital of the world, the local utility recently extended the time it will take for large (100MW+) data centre projects to connect to the grid to 4-7 years, up from 1-4 years previously. There have also been reports of hyperscalers backing out of development deals given a lack of clarity around obtaining sufficient electricity to power those projects. To avoid a deficit, at least twice the data center capacity built since 2000 would have to be built in less than a quarter of the time.

While decarbonization remains a priority, natural gas still has a role to play in bridging the gap to when additional dispatchable baseload power from nuclear and energy storage comes online. This convergence of AI and decarbonization has created unprecedented investment opportunities in the infrastructure sector, across data centers, power generation, and utility networks. While historical power consumption growth averaged a modest 0.5% annually, the next two decades are projected to witness a six-fold increase, primarily fueled by the energy-intensive nature of AI data centers. Industry executives are now pursuing a diversified "all of the above" energy strategy, incorporating a mix of renewables, natural gas, nuclear power, and emerging technologies.

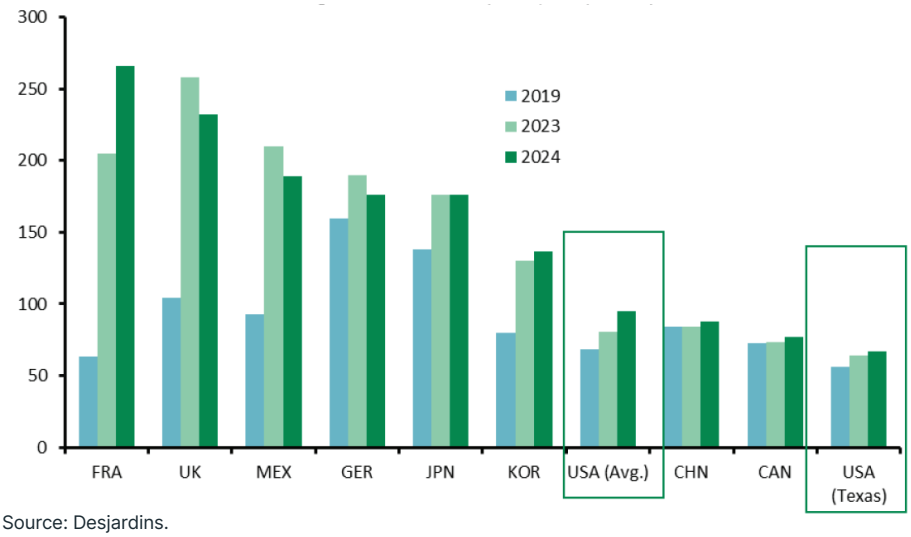
While we are allocating across the spectrum of power generation technologies, we believe Bloom Energy offers a compelling solution by providing rapid deployment of fuel cells for on-site power generation. Unlike traditional grid connections which can take years to establish, Bloom can deliver, install, and power a site within months. This agility is crucial for tech companies seeking to capitalize on the rapidly evolving AI landscape. Moreover, Bloom Energy's technology addresses key industry needs: affordability, reliability, and a path to clean energy through carbon capture and fuel switching capabilities, including the potential for hydrogen utilization.

Alberta and the Permian Basin are Prime Locations for Data Centres

The energy industry has long lamented the challenges of building pipeline capacity from places where energy is produced to places where it is consumed. While this obstacle still remains, the industry is uniquely positioned to provide a solution to the "Time to Power" problem by attracting data centres to Alberta and the Permian Basin – where almost unlimited reserves of natural gas produce the cheapest electricity in the developed world. These markets have excess power generation capacity without the need for significant capital investment to boost utilization.

US has some of the lowest industrial energy costs in the Developed World

Average Industrial Electricity rates, USD per MW/h

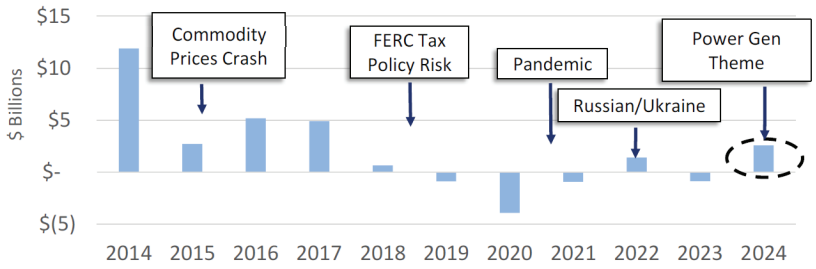


Source: Desjardins.

Power producers in Alberta and Texas are proposing to co-locate data centres with their own existing under-utilized power generation units. These 'microgrids' solve a lot of problems:

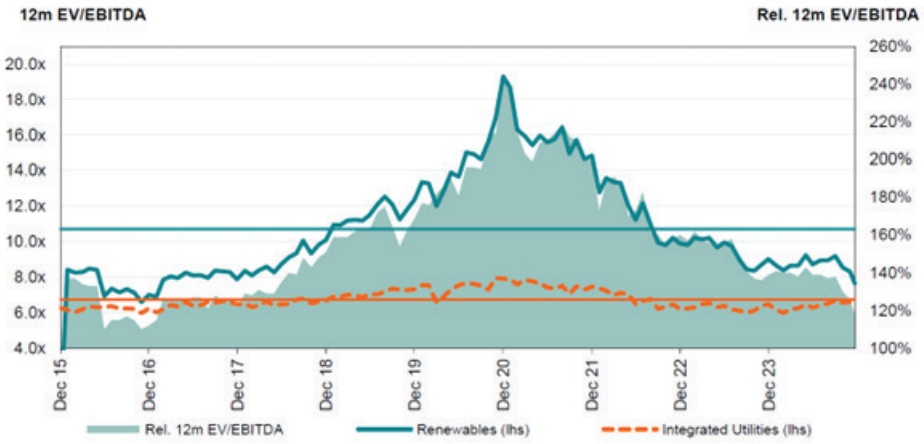
1. **Fuel**: The natural gas trapped without adequate egress capacity is a cheap fuel source for local power generation.
2. **Water**: Recycled water from oil and gas production can be used as an abundant source of cooling.
3. **Microgrid**: Developing power generation facilities onsite that are independent of the grid does not burden the transmission system and local utilities.
4. **Regulation**: Avoids regulatory scrutiny resulting from adding substantial load to the electric grid and causing power prices to rise.
5. **Renewables**: Plenty of land available for wind and solar farms to supplement power generation.

As of this writing, there is 6 GW of demand from data centers currently in the queue for Alberta and 30-40GW in Texas. This demand growth was a driver of returns in 2024, resulting in the sector posting its largest inflow since 2017. We expect positive inflows again in 2025 as successful execution of the currently slated projects will serve as proof of concept and provide better visibility into the runway for growth ahead.



Source: Citi.

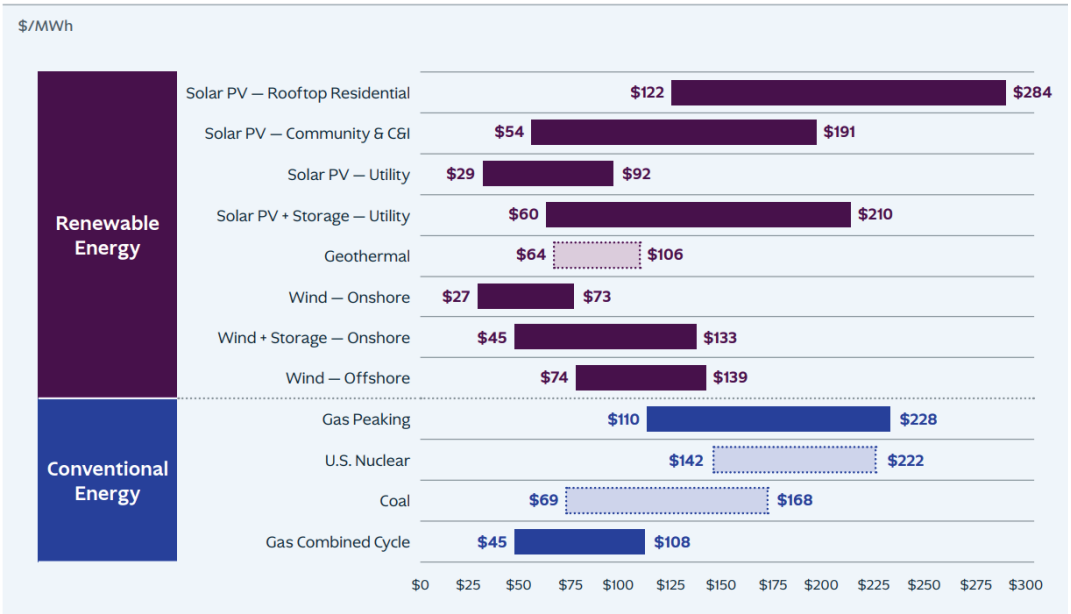
Renewables: A Challenging Year, but Long-Term Potential Remains



Source: BNP Paribas Exane.

We remain bullish on the prospects for the renewable energy sector despite its post-COVID underperformance. Optimism about the energy transition and future growth of the renewables sector drove valuations to unsustainable levels during 2020-2021 period. The subsequent decline was a correction in investor sentiment attributable to rising interest rates and supply chain challenges. While the headwind of interest rates increases has eased somewhat, valuations are far less demanding and long-term demand thematics remain intact.

The Levelized Cost of Energy



The levelized cost of energy from all renewable sources is now cost competitive with fossil fuel-based sources. Technology continues to advance rapidly and the cost of renewable power will likely continue to decrease over time.

Companies in the sector are broadly trading at a significant discount to intrinsic value even as they continue to advance their respective development pipelines. As new projects come online and generate cash flow, the companies that own the assets become better value propositions for investors. If public markets fail to respond, renewables become prime M&A targets for both strategic and financial buyers. Based on our estimation, we see a high probability of mean reversion for renewables in 2025 set against a very low probability of incremental downside from here.

Steady Growth Ahead

As we transition into 2025, we remain optimistic about the long-term potential of infrastructure. Digital connectivity, driven by AI adoption, and ongoing investment in energy and transport systems provide compelling opportunities. While US treasury bond yields have risen since the election, higher expected inflation is positive for infrastructure due to the pass-through mechanisms. Using valuation as our guide, we remain focused on high-quality infrastructure businesses that generate above-average returns across the economic cycle, exhibit capital discipline and are driven by secular growth tailwinds.

The Starlight Global Infrastructure Fund is a concentrated portfolio of 40 high-quality global infrastructure companies with a track record of increasing their cash flows and distributions annually. In 2024 the portfolio generated 34 distribution increases with an average increase of 12.5%. The Starlight Global Infrastructure Fund, Series F's current distribution rate is 5.2%, and 84% of it was taxed as return of capital in 2023.[1]

We invite you to partner with us in harnessing these opportunities in 2025.

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[1] As of December 31, 2024.

Investment Management Team

Hisham Yakub, CFA
Senior Portfolio Manager, Infrastructure

Hisham Yakub joined Starlight Capital in February 2023 as Senior Portfolio Manager. He has over 10 years of experience in the investment industry.

Mr. Yakub most recently held a position with a boutique Toronto-based investment management firm as an Investment Analyst and Portfolio Manager. He also spent the first six years of his business career focused on developing software tools for portfolio management applications. He progressed through several roles across the industry and finished his pre-MBA career at CPP Investment Board.

Mr. Yakub holds the Chartered Financial Analyst and Financial Risk Manager designations and earned a Master of Business Administration from the Rotman School of Management at the University of Toronto in 2013 and an Honours Bachelor of Business Administration degree with a specialization in Information Systems from York University.

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