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INFRASTRUCTURE INVESTOR

Different paths, same destination

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Three senior executives from infrastructure fund managers, three varying strategic models. But Andy Thomson discovers one common denominator: the vital importance of asset management

The three professionals seated around the table – Stephen Nelson of Infracapital, Mark Crosbie of Antin Infrastructure Partners and Stephen O'Shea of First State Investments – all represent fund managers which have, in recent times, successfully raised large amounts of capital from limited partners. That success almost certainly represented vindication for these firms' devotion to asset management. What it also suggests is that how exactly you go about implementing asset management from a strategic point of view doesn't necessarily matter – as long as you are committed to it.

After all, it quickly becomes clear that distinctly different asset management models are being talked about by the trio of participants. Nelson insists that Infracapital's limited partners have bought into a model which involves a clear delineation between the firm's transactions team and its asset management team. The former BAA chief executive, who has more than 15 years of operational and main board experience, says that this separation means "it is quite clear what we want from our people" and that it avoids any "blurring of requirements".

Crosbie, on the other hand, says: "Our selling point is that we do not separate the two. We stress alignment of interest. In other organisations, where you may have the investment team doing a deal and then handing it over to another team, that's fantastic if it turns out to be a great deal because both teams can claim responsibility. But if the performance is not what was anticipated, it can be a cause for conflict. Our view is that you must live with the consequences – if you have an asset off track, then you need to be the one(s) to get it back on track again."

However, both men are quick to agree that there's room for different approaches. And Nelson makes the point that Infracapital's asset managers are "deeply involved" at the pre-investment stage. Furthermore, he adds, the investment and asset management professionals share identical incentivisation schemes.

ALIGNMENT 'VITAL'

O'Shea sees First State's model as something approaching a blend of the other two. "We see ownership of the asset as continuous from the point of origination, and achieving alignment is vitally important. But, at the same time, specific skill sets are applicable. Some of us are more experienced in execution, for example. But the majority of the deal team will progress the asset through the asset management stage."

Whatever the rationale for a particular approach to asset management, opportunities for these firms to demonstrate their skills at the coalface have not been in short supply. Having no doubt incorporated relevant case studies into their investor pitches, all have ready examples of the practicalities of asset management up their sleeves. And all are keen to stress how varied and complex different scenarios can be.

"It's horses for courses," says O'Shea when asked how asset management is typically applied to investee companies. "It's down to the asset in question and the best way to approach it." He plucks three examples from First State's portfolio, the first of which is the Helsingør-Helsingborg ferry route between Sweden and Denmark, acquired from Scandlines and Stena in January. "This was a good old-fashioned joint venture with no corporate structure. So we had to implement that by establishing and incorporating several new companies from scratch," says O'Shea.

On the other hand, Ferngas Nordbayern – a German gas distributor acquired from E.ON in December 2013 – was a business without its own management team. "So we had to build the management team from a clean sheet and ensure alignment of interest and even do things like find office space and put in computers, printers…all the nuts and bolts," says O'Shea.

NEED TO REFOCUS

Also in December 2013, First State was completing the acquisition of Fortum Distribution Finland (since renamed Caruna), owner of the largest electricity distribution network in the Nordic country. The asset management here involved changing the focus of management, whose approach had been shaped as part of a large multinational. "We had to instill the need to refocus away from the next quarter and the next budget cycle to think longer term," says O'Shea.

While the examples given by O'Shea represent particular types of challenges, it may be argued that Antin's acquisition of an interest in terminal operator Euroports in July 2009 equated to most asset management tasks you can think of rolled into one. Crosbie describes it as a kind of “A to Z of asset management”.

He explains: “It had rapidly acquired assets from a variety of different owners and therefore had a great footprint, but there was no integration of the assets at all. We had to look at pretty much every aspect of the business: strategy, divestments, acquisitions, capital structure, refinancing, changing management, controlling capex, removing costs, and operational and performance programmes.”

Meanwhile, Roadchef – one of three major operators of motorway service areas in the UK, which Antin acquired from Israel’s Delek Group in September last year – was “fundamentally a good business with strong management, but was starved of capex”. Antin made fresh capital available within 10 days of its investment and brought in specialists to help develop the firm’s retail offering. It has “tremendous upside”, Crosbie insists.
Crosbie notes that – like First State – Antin has also undertaken its share of corporate carve-outs. These include Central Area Transmission System (CATS), the UK North Sea gas pipeline, riser platform and onshore processing facility; and FPS Towers, a company formed to allow the divestment of Bouygues Telecom’s French telecom towers portfolio.

Neatly encapsulating the need for new premises, management teams and IT systems among other things, Crosbie describes the process like “cutting the umbilical cord from the parent”.

LOVING CARVE-OUTS

Nelson adds that “we [Infracapital] love the complexity of the carve-out. You have to have the skill sets, and that puts some funds off. But it raises the returns if you do it well. With Calvin Capital [an owner and supplier of gas and electricity meters to utilities in England] we kept the management small but we put in a new CEO and that business has grown dramatically due to a combination of investment and operational skills”.

Nelson also cites UK water utility Affinity where – alongside investment partner Morgan Stanley – he claims that “an active asset management approach has played its part in Affinity moving from being considered one of the poorest performers in the previous regulatory period to being one of two to get enhanced in the recent round of Ofwat determinations.”

Nelson goes on to discuss how his firm has worked closely with the management at Isle of Wight ferry operator Red Funnell in areas such as passenger flows, marketing and capital structure. O’Shea adds that at First State “we never seek to replace the management team, we seek to assist and empower them”.

At this point, Crosbie offers the view that – while not necessarily a pleasant task – replacing management may nonetheless be the responsible course of action when there are incumbent failings. “It’s not our strategy to replace management but we’re not afraid to recognise that you can have a very good business with mediocre management. We’re great believers in management – they’re absolutely pivotal. We’re not setting out to change things, and we’d love not to have to do it, but we don’t shy away from change where it’s necessary,” he says.

Nelson adds that, where the management team is the right one, it is important to optimise relationships between portfolio company and fund manager. “Do our people have good interpersonal skills? Can they build credibility with management? Do they care enough about certain issues to allow the management team to flourish? We need to expect these qualities in our colleagues and they are probably overlooked.

You have to keep building relationships and not be held at arm’s length.”

‘BLEND OF SKILLS’

“You need a blend of skills and some of that is about softer skills,” acknowledges O’Shea. “They can be key. If you can speak the same language as the management team then that obviously helps, but when you can also provide expertise and guidance from people with similar professional or technical backgrounds, it gives you enormous credibility in their eyes.”

He adds: “Management are often from the local community and are proud of their business. You have to make it clear that you’re showing faith in them and you want them to be best in class. That can be very empowering to them.”

Reaching for an example of good alignment with a management team and the benefits that it can bring, Crosbie alights upon Porterbrook, the UK rail rolling stock company which was sold to a group of institutional investors towards the end of last year. “We made sure there was a well-defined agenda which specified what we wanted to do and how much time we had to do it,” he says. “And we offered management an incentivisation package with very clear alignment so they could achieve significant upside.”

He adds that the packages referred to were agreed even before the deal had completed, so everyone knew exactly where they stood from day one. The plan for the business included optimising a previously inefficient and short-term financing structure, including tapping new capital pools such as the US private placement market. It also involved a large capex programme to both refurbish (and extend the lives of) existing trains and buy new ones. In sum: “There was no disagreement as to the plan. They [management] knew when an exit was coming and they knew the key milestones which had to be achieved along the way.”

Nelson stresses that the asset management effort at his firm is brought to bear right from the beginning of the deal process. “We pay a lot of attention to getting knee deep in due diligence and we do lots of testing in areas such as finance, regulation, tax, structuring etc. And we debate it with the investment team. I can’t sign off on a bid and then say I never believed in it.”

COST OF CAPITAL

Talk turns to the increasing importance of asset management in a market where fund managers cannot compete on a cost of capital basis against growing numbers of direct investors. Effectively, they will live or die by their ability to show that they have the resources and skills to add value and outperform their direct investment cousins.

“All the value that we bring is through asset management,” says O’Shea, putting it in stark terms. “Doing deals is great but owning and managing the assets properly is what adds value.”

“There is a huge amount of capital coming into the market from direct investors but they don’t have the manpower or skills that we do,” insists Crosbie.

Nelson adds that the value fund managers provide comes not just from driving growth but also from effectively managing risk. “It’s about making sure that you can deliver what was priced into the bid,” he says. This includes focusing on areas such as health and safety, which he describes as “massively important and often overlooked”.

“Health and safety has been one our biggest areas of focus in Euroports,” Crosbie adds. “It had a poor record before we acquired it so we did safety walks and made it highly visible that, as shareholders, we valued health and safety. It brings intangible benefits such as a happier workforce and good relationships with port authorities and unions.”

Given the existence of positive stories such as these, the participants are asked whether they feel the asset class communicates its achievements well enough. “I don’t think what we do is as well understood or as well communicated as it should be,” says Crosbie. “There is a perception about private equity of short termism, ‘flipping’ investments and asset stripping – and that’s a legacy issue. In our subset of private equity, we’re longer term and much more interested in growth and development but there is a long way to go in making that understood.”

‘CAN’T HIDE BEHIND OWNERSHIP’

Adds Nelson: “A lot of the assets we buy are essential services businesses and you have a very interested set of stakeholders. You can’t hide behind ownership structures. You’ve got to talk to the politicians and the regulators and, if you’re a buccaneer who’ll flip the asset after a couple of years, the conversation will stop right there. Responsible ownership has to be in your DNA.”

“The first thing we do with our forward pipeline, if it’s a regulated business, we go and meet the relevant stakeholders and particularly the regulator,” says O’Shea. “You introduce yourselves and get talking and, at some point, you’re aware of a light flicking on in their minds when they begin to appreciate what your ownership of the asset really means as a long-term, buy and hold investor.”

The conversation then takes an unpredictable turn when, in thinking about the range of stakeholders that fund managers can find themselves dealing with, O’Shea mentions the involvement of the Royal Society for the Protection of Birds (RSPB) in its investment in Anglian Water given that the UK utility owns sites which are home to nesting ospreys. This prompts Nelson to reveal that Infracapital has its own issues with peregrine falcons on telecom towers.

An arguably less exotic but nonetheless vitally important breed is the limited partner investor. Unsurprisingly, for those around the table, asset management is a major part of the investor dialogue. “You have to go the extra mile with investors,” says Crosbie. “You tell them about your plans, what you’ve achieved, what’s coming next and how far you are along the journey.”

Crosbie adds that Antin’s investor meetings are shaped around addressing these points, including “very detailed” case studies.

O’Shea adds that getting management teams to talk about asset management at investor meetings represents a useful “touching point” between the two. He says First State likes to give management teams a chance to establish contact and keep in touch with each other and have productive dialogues.

Nelson concludes: “They [investors] really like to hear about the asset management detail. Of course they like to hear about returns and track record as well, but across geographies and across different types of investor, people are always interested in asset management.”

AROUND THE TABLE

Mark Crosbie, managing partner, Antin Infrastructure Partners

Crosbie was for seven years the director of corporate strategy, development and M&A and was a member of the executive committee at Centrica. He previously held senior roles at UBS and Peregrine Investment Holdings in Hong Kong. While leading the M&A team at Centrica, he completed around 60 transactions across the UK, Europe and North America.

Stephen Nelson, asset management director, Infracapital

Nelson was chief executive of BAA Ltd between 2006 and 2008 when it was the UK's leading owner and operator of airports including Heathrow, Gatwick and Stansted. Prior to this, he was group retail director at BAA. Before joining BAA, Nelson was group marketing director and group trading director at J. Sainsbury. Currently, he is also a non-executive director of the Office of Rail Regulation.

Stephen O'Shea, director, direct infrastructure, First State Investments

O'Shea has responsibility for the origination, execution and management of investments in unlisted mature economic infrastructure assets for the First State Investments European Diversified Infrastructure Fund (EDIF). Having been with First State for almost seven years, he previously spent more than six years at banking group ING, where he was a vice president in London.