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WEEK IN REVIEW

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Core-plus is not what it used to be

Bolder fund managers have done well by turning riskier corners of the market into assets direct investors like to buy. Reprising this feat will require them to think even further outside the box.

Last Thursday, it emerged that the Ontario Teachers' Pension Plan and the UK's Universities Superannuation Scheme had teamed up to buy Westerleigh, a crematorium business, from Antin Infrastructure Partners. The name rang a bell: we covered Antin's purchase of the company less than four years before, and have referred to it multiple times since.

With good reasons. At the time of its acquisition by the fund manager, few blue-chip investors had put crematoria on their core infrastructure radars, and Antin's move raised eyebrows. In the following months, we therefore cited Westerleigh as the archetypal 'hybrid' investment: assets that wouldn't be out of place in a private equity portfolio, but which have characteristics that make them worthy of the infrastructure label, their backers argue.

But here's a lesson from last week: what was hybrid four years ago may no longer be today. OTPP and USS, which will soon be Westerleigh's new owners, are hardly racy investors, preferring infrastructure assets for the stable, long-term yield they provide rather than their potential for outsize returns. Obviously, changes of strategy happen, even within large-scale institutions. But it doesn't seem to be the potential for private equity-like returns that induced the two buyers to dip into their pockets.

The statement OTPP and USS issued on the deal was short on details, and all parties involved declined to disclose any financial information. But we understand that Westerleigh witnessed solid growth under Antin's tenure – to the point, we infer, that it passed the deal size threshold of two of the world's largest LPs, whose direct investments typically amount to several hundred million dollars. The year prior to Antin's purchase, Westerleigh reportedly generated £22.2 million ($27.6 million; €25.9 million) in revenue. Most importantly, however, it appears that both investors were convinced that the high barriers to entry and the essential nature of the services provided by UK crematoria were enough for them to put the business in their infrastructure bucket.

This isn't the first time something like this has happened. For example, when infrastructure funds first came to the fore prior to the financial crisis, rolling stock lessors were generally not in the crosshairs of core infrastructure investors. But in recent years ROSCOs, as they are known, have become popular among classic infrastructure players. Eversholt Rail, one of the UK's three large operators, was sold by a group of fund managers to Cheung Kong Infrastructure last year for £2.5 billion. Plenty of smaller peers have also changed hands.

Some fund managers have defined their strategy as core-plus from the start. Others, like 3i Infrastructure, have gone more forcefully down that route after seeing returns compressed in the asset class's mainstream. All of them have since put their money where their mouth is by backing the likes of diagnostic labs, airport kit lessors, motorway services areas and emergency rescue vessels for the offshore energy industry.

These may one day become core infrastructure sectors in their own right, or at least assets that LPs are happy to back themselves. In some cases, this will require fund managers to straighten them into higher-yielding, safer businesses, for example by lengthening contract terms or tweaking the financial structure. In others, it will be about bringing them to scale and successfully demonstrating the infra-like characteristics of the assets. The strategy seems sound, but is it sustainable? Ironically, the more core-plus managers are successful in bringing the fringe to the mainstream, the further they have to go to find the next frontier. To be continued.