ROUNDTABLE

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The magic of the mid-market

The seven mid-market managers in this year's roundtable discuss their respective approaches to mitigating the effects of spiralling inflation and supply-chain disruption with Amy Carroll and Zak Bentley

The mid-market has long been lauded for its deluge of dealflow coupled with limited competition. But with a host of mega managers returning to their roots in search of less hotly contested opportunities, is this capacious segment starting to feel more crowded?

The answer to that question varies, depending on who you ask. Chantale Pelletier, global head of infrastructure for Schroders Capital, says that while the mid-market does feel somewhat more congested with big players launching mid-market strategies, the sheer volume of potential targets still makes it possible to access good deals, particularly if you have a local presence. "The mid-market is all about the future of infrastructure," she says, "which means that there is an abundance of energy transition and digitisation opportunities being shaped by the mega trends of our time."

Spence Clunie, managing partner at Ancala Partners, however, denies that the mid-market is becoming more competitive. "We have seen a lot of players leave this space, even if there are some large managers now seeking to move back," Clunie says.

He adds that competition is likely to remain sparse, given that it is only going to get harder for new entrants to raise funds. "It will be challenging for emerging managers to make inroads over the next few years as we head into a higher inflation, higher interest rates and low to negative growth environment. A good track record is going to be imperative for accessing capital from LPs."

Michael Hoverman, principal at CIM Group, says: "The infrastructure industry is effectively upside down when compared to other asset classes such as private equity and real estate. In the US, the entire mid-market is smaller than the biggest mega fund. I believe this creates a significant amount of mid-market investment opportunities and a ready-made exit route for those assets as well."

Antin Infrastructure Partners, of course, is one of those mega managers that has recently returned to the mid-market, having closed its inaugural mid-market fund on its €2.2 billion hard-cap in 2021. The strategy is managed by the same team that oversees Antin's flagship vehicles and Antin partner Hamza Fassi-Fehri is unapologetic about his firm's injection of fresh capital into the segment.

"Our roots are in the mid-market and while the competitor landscape across the entire asset class has evolved, there remains a large and diverse investable universe of businesses with more limited competition," he says. "There are therefore significant opportunities for bilateral or negotiated deals, which have been an important part of Antin's history. There are also more opportunities to add value with businesses of this size and scale. These are assets that really benefit from strategic advice, network relationships and access to capital."

This is a message echoed by Phoebe Smith, senior director at PATRIZIA. "There are vast numbers of SMEs around the world that could benefit from institutional capital to help them scale. We can be that first step on their institutional capital journey. The mid-market is so large that we can all pursue bilateral negotiations without necessarily bumping heads."

Stéphane Calas, managing director at Cube Infrastructure Managers, meanwhile, points out that competition is further diluted by the different strategies being pursued by mid-market managers.

"Our definitions of the mid-market differ," he says. "Some firms that call themselves mid-market investors may be looking at the higher end of the spectrum, whilst others, like us, focus on the lower end, investing in earlier stage assets that offer a platform for growth. For me, it is that lower end comprised of companies below the radar of larger investors that remains the least crowded and the most attractive.

"We see mid-market as the segment where bilateral transactions are achievable. We are securing deals, not just on price, but based on our ability to forge relationships with company management and structure deals that meet the needs of both parties."

Willem Jansonius, partner at DIF Capital Partners, agrees that the lower mid-market is not especially crowded. "Given our local boots on the ground, we come across ample opportunities in the $50 million to $150 million space, especially in the newer infrastructure segments," he says. "But when you start to move into that upper mid-market – $200 million and above – where you would expect to see the mega managers that are returning to the mid-market, then competition intensifies significantly."

"The current economic environment hasn't changed our underlying strategy, but it has made us more cautious about locking in cost before committing to projects"

SPENCE CLUNIE
Ancala Partners

"While the competitor landscape across the entire asset class has evolved, there remains a large and diverse investable universe of businesses with more limited competition"

HAMZA FASSI-FEHRI
Antin Infrastructure Partners

A mega approach to the mid-market

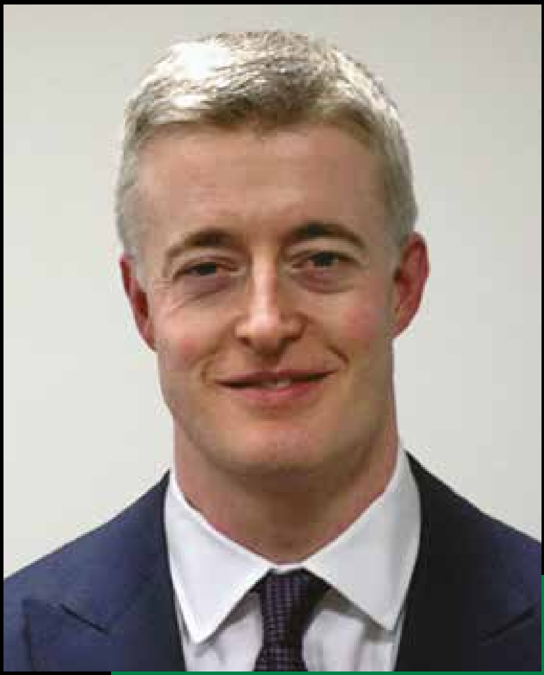
Of course, the primary reason that the big infrastructure managers are looking to pursue mid-market strategies is to capture LP demand. Investors recognise the benefits of mid-market exposure, while at the same time pursuing a trend of consolidating manager relationships. But is that necessarily the best approach?

Clunie believes that from an LP's point of view, it is always better to have a team dedicated to maximising value through a single strategy. "Devoting resources to finding unique opportunities that are often missed by managers that don't have that focus is how you generate the best returns with the best downside protection."

Hoverman adds that is not only about an exclusive focus on the mid-market, but also about a focus on geography. "If you are going to unearth these off-the-radar opportunities it takes a local presence," he says.

Jansonius agrees. "The depth of local networks is critical in the mid-market, right down to the ability to speak the local language," he says. "Not all mid-market companies in Europe are proficient in English."

Cube IM is another manager



Spence Clunie
Managing partner, Ancala Partners

Spence Clunie has over 28 years' experience of investing in and managing infrastructure assets. Prior to founding Ancala Partners in 2010, he was a senior managing director at Macquarie in Europe.

Hamza Fassi-Fehri
Partner, Antin Infrastructure Partners

Hamza Fassi-Fehri joined Antin in 2011 and is based in the firm's New York office. He previously worked at JPMorgan in Paris where he was part of the investment banking team.

Michael Hoverman
Principal, CIM Group

Michael Hoverman is a principal and head of the Global Partners Group at CIM Group. Prior to joining the firm in 2014, he was a vice-president of infrastructure and real assets at Macquarie.

Willem Jansonius
Partner, DIF Capital Partners

Willem Jansonius is head of CIF (the core-plus infrastructure strategy at DIF). He has 20 years of experience in investment banking and private equity across the energy, TMT and infrastructure sectors. He previously worked at Macquarie, Cyrte Investments and ABN Amro.

Stéphane Calas
Partner, Cube Infrastructure Managers

Stéphane Calas is the partner in charge of Telecom & Smart Infrastructure for Cube IM's flagship funds. Since joining Cube IM in 2010, Calas has primarily focused on the telecom, energy transition and public transport sectors. He previously worked in investment banking at Dresdner Kleinwort and Commerzbank and in corporate finance at PwC.

Chantale Pelletier
Global head of infrastructure, Schroders Capital

Chantale Pelletier is responsible for the growth and development of Schroders' infrastructure investment platform. She joined Schroders in 2021 from Canadian pension CDPQ, where she spent more than 20 years in senior roles.

Phoebe Smith
Senior director, PATRIZIA

Phoebe Smith was made a senior director at PATRIZIA when the firm acquired Whitehelm Capital in 2021. She previously spent more than 10 years as a senior investment director at Whitehelm in London and has also worked at Hastings Fund Management in Australia.

exclusively focused on the mid-market, although the firm has created a separate greenfield mid-market strategy. "Crucially, we have created a separate team to run that strategy," says Calas, "because it is important to be a specialist in what you do."

Smith, meanwhile, believes her team has found the perfect balance following PATRIZIA's acquisition of Whitehelm Capital in 2021.

"The key is whether these big managers have sufficient depth of experience in the mid-market – the ability to really create these opportunities and then to add value over the investment period by working alongside entrepreneurs," she says. "PATRIZIA's acquisition of Whitehelm, one of the first investors in the mid-market space, is allowing our team to amplify what we were already doing, but with the support of more offices across Europe, deep local relationships and unrivalled data intelligence to help us make better investment decisions, which is providing depth and breadth to our existing approach."

Fighting inflation

The economic environment that managers are now facing is, of course, challenging for everyone, regardless of the size of their platform. In particular, spiralling inflation and supply-chain disruption are focusing firms' attentions on development risk.

For Cube IM, development risk is an integral part of the firm's buy-and-grow strategy. "It is not something we can or want to avoid. It is in our DNA and is consistent with the background of Cube's founders, who all share an industrial background," Calas explains.

"We target segments that have strong growth potential and seek to capture our fair share of that growth. We haven't changed our investment strategy in this inflationary environment or because of the increased supply disruption risk. We have, however, adapted our asset management strategy by having more frequent interactions

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CHANTALE PELLETIER
Schroders Capital

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PHOEBE SMITH
PATRIZIA

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STÉPHANE CALAS
Cube Infrastructure Managers

with managers to address such topics, building up inventories at portfolio company level to make sure they don't run short of key equipment necessary for their development and deployment plans and ensuring fixed cost contracts are in force for new projects."

Jansonius also believes it is necessary to take some development risk in order to generate outsized returns. "A lot of these supply-chain issues are very difficult to predict. They are not easily avoided," he says. "So, we don't try to structure it away, but we do try to manage it through diversification in our funds."

Fassi-Fehri adds that in light of supply-chain and labour constraints, Antin is focused on de-risking much earlier in the development cycle, for example, securing large scale orders or locking in EPC capacity well in advance of construction starting. "Those de-risking measures allow our portfolio companies to stand out from their peers as many customers are placing increased emphasis on project deliverability in addition to project cost."

Hoverman adds: "We are very happy to take development risk when it primarily involves the expenditure of our time and resources – so long as we think we will be well compensated for that."

There is also a distinction between buying assets and buying businesses, according to Pelletier. "When we buy a standalone asset, obviously any development risk is higher, so we focus more on a brownfield, ready-to-build profile," she says. "But when we invest in businesses it is different. There is already a portfolio of assets there and that diversification means we can afford to take a bit of development risk."

Clunie, meanwhile, says that Ancala invests in brownfield first and only pursues development later. Again, he says that approach hasn't changed, although the firm is more focused than ever on securing fixed price contracts with good credit quality counterparties. "We continue to develop existing assets. For example, we are increasing one of our geothermal facilities by 30MW, but that capex has been locked in with solid counterparties," he explains. "In short, the current economic

Energy insecurity

The war in Ukraine has everyone's attention, but the energy transition is not slowing

A major international conflict following hot on the heels of a global pandemic has sent shock waves throughout some of infrastructure's most prolific sectors, and nowhere has the impact been felt more keenly than the energy industry.

"The impact of the Ukraine conflict cannot be underestimated. Energy security is an evident priority in the short term, especially in Europe, which may require some short-term fixes using more traditional sources of energy," says Antin's Hamza Fassi-Fehri.

"In the long term, however, I see no meaningful slowdown in the energy transition. If anything, it is accelerating. Demand for net zero has moved past only governmental pledges and is now rooted in nearly every business' corporate strategy."

Schroders' Chantale Pelletier agrees. "Conflict in Ukraine has added a new objective in terms of security of supply, but the focus on net zero has not gone away. There may be questions raised about what is considered acceptable and what is not, particularly around nuclear and gas, for example. But the energy transition agenda remains strong."

PATRIZIA's Phoebe Smith says: "I also think the current situation will bring more focus onto energy abatement, whether that's through smart meters, smart grids or improving the efficiency of data centres. These are all areas where infrastructure investment can help support the energy transition and provide greater security around energy supply.

"A key catalysing force for this improvement in overall system efficiency will be smartening up cities and deepening interconnectivity. Smart cities will enable us to use technology to address some of the biggest global themes, including urbanisation, sustainability and resource scarcity."

Furthermore, the mid-market is ideally suited to take advantage of these opportunities. "As mid-cap players, we can invest in new segments relatively early on," says Stéphane Calas of Cube IM. "For example, we have been investing in EV charging infrastructure for several years. There were no large-cap assets for the big infra managers in that space to acquire and it allowed us to be ahead of the crowd. We have also been investing in networks dedicated to IoT and enabling smart metering and smart cities, which will contribute to monitoring and reducing the carbon footprint of our economies. You can do that in the mid-market, but it may not be possible in other segments."

Smith agrees that mid-market businesses are more agile than their larger counterparts. "They are quicker to seize these opportunities when it comes to decarbonising the economy," she says. "They recognise that net zero cannot be achieved by wind and solar alone. It is going to take a far broader range of solutions."

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> **CIM Group**

environment hasn't changed our underlying strategy, but it has made us more cautious about locking in cost before committing to projects."

Smith, however, says that supply-chain and inflation risks are best managed through close relationships with contractors and suppliers. "You need to make sure you are having those conversations early, rather than just relying on a fixed price contract," she says.

Just how badly some sectors might be affected by inflation remains to be seen. Infrastructure prides itself on its resilience, but the asset class has not experienced any significant inflationary pressures for decades, while in the meantime, its parameters have expanded dramatically.

"We will find out over the next few years which assets have the infrastructure qualities they are supposed to in terms of revenue inflation linkage and not just cost inflation linkage," says Clunie. "GPs that have ventured into assets that don't have that downside protection will struggle because we are seeing cost inflation across the board – not just with capex, but opex as well. If you can't pass those through, you will be squeezed at an EBITDA and cash-flow level. And if, on top of that, you are highly leveraged, you will face even greater challenges."

Calas agrees. "We will soon see whether these infra-light and infra-like assets that have sometimes stretched the definition of infrastructure into private equity territory really have the infrastructure characteristics required to make them resilient," he says.

"While we have seen disruption in the supply chains and growing inflation pressures, we haven't seen yet the full impact of this new economic environment on the companies themselves – their ability to pass on inflation of costs to their customers, to finance and refinance their capex plans and achieve their growth objectives. Only time will tell which segments will and will not sustain the crisis." ■