ROUNDTABLE

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Scaling up

The ability to grow assets from a low base and then achieve premiums for scale at exit means the mid-market opportunity is as compelling as ever, eight infrastructure professionals tell Amy Carroll and Zak Bentley

Access to differentiated dealflow, value creation opportunities and superior exit prospects are all driving appetite for mid-market infrastructure in today's challenging economic environment.

"The mid-market is an amazing place to be," says Laurent Chatelin, partner at Eurazeo. "From an investment perspective, you have better access to proprietary situations, and you are really able to tailor investments when structuring the deal, which allows you to mitigate risk."

Investors, anecdotally at least, are buying into this mid-market narrative. "We are seeing an overall uptick in LP demand," says Surinder Toor, managing partner at Arjun Infrastructure Partners, who adds that LP interest in infrastructure overall is buoyant. "It certainly feels as though investors are getting ready to put money to work once again. Infrastructure, as an asset class, has fared well over the past few years. It has proven its credentials and that has created tailwinds when it comes to fundraising."

Ian Harding, managing partner at Arcus Infrastructure Partners, adds that at a time when inflation and interest rates are high, investors are looking for outsized levels of returns and mid-market returns appear to have outperformed the large-cap space over the past four to five years.

"In the part of the market where we are operating, it is possible to buy relatively small but solid businesses and grow them into bigger and better businesses that can be sold to large-cap managers at higher multiples than when we entered," Harding says. "There isn't that same opportunity to scale and de-risk and to create such outsized returns when you are buying mature, large-cap businesses. You can't grow as quickly, and you can't get the same degree of multiple expansion."

Gianluca Minella, head of infrastructure research at InfraRed Capital Partners, meanwhile, says that the role of infrastructure in strategic asset allocations has changed. "It used to only be a diversifier from fixed income, but it is now also seen as a returns enhancer.

"Mid-market firms that operate at the core plus or value-add end of the risk spectrum are particularly benefiting from this shift. This is in part because, in addition to those demand drivers, there are also supply drivers at play. There are only so many airports or toll roads for large-cap funds to go after, while the big trends of our time, such as the energy transition, typically lend themselves to smaller deals."

Minella says that in the current environment, capital velocity has become increasingly important to investors as well. "LPs not only need to generate higher returns, but they need their capital to churn faster. Typically, those needs are better served in the mid-market, where exits are easier," he says.

Gautam Bhandari, co-founder and managing partner at I Squared Capital, agrees that exit dynamics in the mid-market are one of the key advantages that the segment offers. "There is a rarified universe of buyers for larger assets, particularly as the IPO markets

are not particularly conducive to infrastructure. The art is to take something from small to mid-market or from mid to large. If you are able to navigate either one of those journeys you will be able to generate substantial alpha for your LPs."

"Investors see the benefit of us being able to grow companies, employing buy and build strategies, and transitioning investments into the upper mid-market or even large-cap space. That is a narrative that really resonates," agrees Maciej Tarasiuk, head of investments, core infrastructure at abrdn.

Mac Bell of Fengate Asset Management, meanwhile, comments that investors like the lower mid-market, as long as they are convinced the manager is going to eke out the additional return that makes the extra effort of deploying capital through smaller tickets worthwhile.

But Bruce Chapman, partner and co-founder of Threadmark, says it is important to distinguish between talk and action when it comes to investors' appetite for mid-market funds. "A lot of investors have been talking about the mid-market for some time, but the majority continue to deploy most or all of their capital with large cap managers," he explains.

"We are in the midst of a multi-decade evolution, however, that in many ways resembles the trajectory followed by private equity. Back in 2003, when the private equity industry was recovering from the dotcom bubble and September 11, the mid-market was pretty thin. Now there are thousands of firms in the mid-market space including a diverse mix of sector specialists and generalists.

"There are also multiple different stratifications with a lower mid-market, mid-market and upper mid-market. When it comes to infrastructure, the bulk of capital going into the mid-market is currently going into the upper mid-market while the lower mid-market is understandably the least developed. But it is inevitable that this will

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Arjun Infrastructure Partners

"Going forward, we think that investors will focus more on diversifying their manager relationships, especially given the recent consolidation in the market"

BRUCE CHAPMAN
Threadmark

Maciej Tarasiuk
Head of investments, core infrastructure, abrdn

Maciej Tarasiuk oversees the investment activities of abrdn's core infrastructure strategy and is an investment committee member. He has over 16 years' infrastructure M&A and investing experience, across Macquarie Capital, MAP Airports, OTPP and Amber Infrastructure.

Ian Harding
Managing partner, Arcus Infrastructure Partners

Ian Harding was part of the team that founded Arcus in 2009. He previously worked in Babcock & Brown's infrastructure team, as well as Citigroup's infrastructure advisory group and NM Rothschild's natural resources team.

Surinder Toor
Managing partner, Arjun Infrastructure Partners

Surinder Toor is the founding partner of Arjun Infrastructure. He was previously head of Europe for JPMorgan's Global Infrastructure Investment Fund, as well as CFO at Scotia Gas Networks and managing director at American Electric Power's European operations.

Laurent Chatelin
Partner, Eurazeo

Laurent Chatelin joined Eurazeo as head of the infrastructure team, having previously been a partner at Marguerite, a European infrastructure manager he joined at inception in 2010. Chatelin has also worked with ABN Amro and Macquarie Capital. He started his career at Alcatel-Lucent, structuring project finance base solutions for the group's clients.

Bruce Chapman
Partner and co-founder, Threadmark

Bruce Chapman has over 22 years' experience of capital raising and corporate finance and has raised capital for more than 50 different private equity, infrastructure, energy and credit opportunities since 2001. Prior to co-founding Threadmark in 2009, Chapman was a partner at CP Eaton Partners and vice-president with Continental Capital Partners.

Mac Bell
Managing director, infrastructure investments, Fengate Asset Management

Mac Bell joined Fengate Infrastructure in 2013 and leads the social and transportation investments team. He has been involved in many large projects, including JFK Terminal 6, LAX ConRAC and Edmonton Valley Line LRT. He previously worked in the renewable power sector with a Vancouver-based developer that is now part of Innergex.

Gianluca Minella
Head of infrastructure research, InfraRed Capital Partners

Gianluca Minella leads InfraRed's research function. He was previously head of portfolio strategy and research at ADIA. Minella has also been head of infrastructure research at DWS and worked at Fitch Ratings and Standard & Poor's.

Gautam Bhandari
Co-founder and managing partner, I Squared Capital

Gautam Bhandari co-founded I Squared Capital in 2012. He is the global CIO of ISQ and has been a member of the executive committee since its inception. He is also the co-chair of the firms' Operating Committee.

evolve over time, not least because it is the lower mid-market that is actually producing some of the best returns."

And it is returns, of course, that will ultimately determine where investors allocate. "At the end of the day, performance is what matters. Allocators are going to look at your returns track record above all else. But I do believe that our position as an independent manager within a broader group that can offer investors exposure to debt and private equity, along with infrastructure, is compelling," Chatelin explains.

Specialism vs multi-strategy

While LP appetite for the mid-market appears to be blossoming, investors are increasingly faced with the choice of deploying capital with independent mid-market specialists, or else working with multi-strategy platforms as the infrastructure asset class continues to consolidate.

"Some very large public pension schemes just want to park large commitments with multi-strategy asset managers across their different funds. It makes their administration easier," says Harding. "But then there are also investors looking for a greater degree of specialism. We focus on being a good GP in the European mid-market, value-add space. We don't want to be all things to all people. I think there is a place for both approaches."

Chapman agrees. "There are many investors, including some of the largest allocators in the world, that would rather invest across multiple strategies with well-established groups – the big brands. Others, however, would rather invest with single strategy managers, particularly at the lower end of the mid-market, where specialism and independence are key. Going forward, we think that investors will focus more on diversifying their manager relationships, especially given the recent consolidation in the market."

Tarasiuk says that LPs in infrastructure funds have become significantly more sophisticated about their asset

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MACIEJ TARASIUK
abrdn

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MAC BELL
Fengate Asset Management

allocations, which means while larger managers offer a one-size-fits all approach, they are now able to select complementary strategies, either by size or investment approach, that can support overall portfolio composition.

"We don't see ourselves competing against the one-stop shops," adds Toor. "I think it's about demonstrating your specialism – your expertise – and being able to show your pipeline. That's what really attracts investors."

Fengate, meanwhile, targets PPP opportunities, as well as energy transition and digital infrastructure plays in North America. According to Bell, the team regularly debate whether they should break those strategies up into separate buckets. "For now, the conclusion is that we are already specialised enough, with our exclusive focus on North America. Ultimately, we think we have found the right balance."

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> **IAN HARDING**
> **Arcus Infrastructure Partners**

"The reality is that if you are a smaller GP you need to specialise either geographically or sectorally in order to produce alpha," says Bhandari. "Conversely, if you have a fund that is over $5 billion, you cannot afford to specialise because otherwise you will run out of attractively priced assets in your niche sector and fail to generate alpha. LPs appreciate those nuances. They are far more sophisticated when it comes to asset allocations today than they were 10 years ago."

Hot hunting grounds

One of the most frequently touted advantages of the mid-market is that it is particularly conducive to investment in some of the most exciting infrastructure sectors of our time.

"The big changes taking place in society are all relatively recent, which means there are no incumbent giants. The energy transition and digital infrastructure sectors, for example, are still very fragmented and wherever there is fragmentation, mid-market firms can thrive," says Bhandari.

Of course, the sectors that command the most attention from mid-market investors are constantly evolving.

"There are sectors that were nascent five years ago that are now starting to become investable. For example, we weren't comfortable with EV charging three to five years ago. The projections weren't always realistic and valuations were sky high even where there was no real asset backing or contracts in place," says Harding.

"Now these companies have evolved to a point where they have real assets and real contracts in place. They are starting to generate cashflows and so are starting to now become investable for managers like us. In another five years' time, we could be saying the same thing about hydrogen-related infrastructure, or battery storage or the digital infrastructure associated with AI. The exciting thing about the mid-market is that it is constantly evolving."

For Fengate however, the focus has been on achieving alpha by going further up the risk curve in sectors that the firm is already familiar with, rather than investing in sectors that are entirely new. "That might mean getting involved a little earlier in the development phase, for example," Bell says.

Tarasiuk, meanwhile, says his firm is continuing to see opportunities coming out of a public sector seeking to deleverage. "In Finland, for example, we have been involved in the privatisation of municipality electricity and district heating assets. In Italy, we have been involved in biogas projects and in Poland with solar. In the UK, we started out with a sub-€50 million initial investment in railway rolling stock that has now reached €500 million in size across the various investments, making it interesting to large-cap investors. The opportunity set does tend to differ depending on the geography."

Minella, however, says there has been a partial shift away from thinking about infrastructure sectors, with a greater focus on the powerful trends underpinning demand instead – a move reflected by various LPs who are focusing on thematics rather than only sectors. "Is EV charging an energy or transportation play, for example? Those types of questions are important because thematics have the power to change sector risk profiles. A large utility that might have been bought at 5 or 6 percent 10 years ago as a long-term hold, might now be exposed to the energy transition and be considered a riskier proposition."

Data centres

One sector – or thematic – that has undoubtedly commanded a huge amount

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> **I Squared Capital**

of focus and dollars in recent years is, of course, digital infrastructure, and data centres, in particular. The sheer scale – and huge valuation multiples – that now characterise the space, however, mean many mid-market investors have had to reconsider their approach.

For Arcus, the solution has been to aggregate scale. "Our third fund has recently started a data centre strategy whereby rather than paying a premium for scale, we are buying smaller facilities along with some greenfield expansion," says Harding. "We are aggregating data centres of a modest size in order to create a scaled platform across the European market much like we did with cold storage to create Constellation Cold Logistics. That kind of strategy involves a lot of hard work, a lot of M&A and integration, but as a mid-market value-add manager, that is what our LPs pay us to do and, ultimately, they should be rewarded with a premium for scale at exit."

For InfraRed, meanwhile, the solution has been to switch geographies. "The large-scale data centres in the US are going for very high valuations but digital habits are pretty similar wherever you look in the mature markets," explains Minella. "Our approach in a situation like this, therefore, is to focus on edge data centres, and/or regions that are less expensive while sticking with what remains a powerful theme."

Fengate, by contrast, has been able to leverage its multi-asset class platform. "We recently made a large investment to bring a data centre business that was incubated through our private equity group while at a higher risk stage of development, into the infrastructure business as it reached maturity," says Bell. "We believe there is still plenty of opportunity for that kind of scale to core approach."

For Eurazeo, the answer has been to stay away from hyperscalers and to gravitate to the edge, instead. "Edge data centres remain highly fragmented in Europe. There are lots of corporations looking to outsource their data centre needs, which is why we started to build an edge data centre operator a few years ago," says Chatelin. "We have completed a string of bolt-ons in France and are now looking at opportunities in other countries."

Meanwhile, for Arjun, the challenge with the data centre proposition is less about scale or valuation, and more about risk profile. "The majority of data centres don't fit our core to core plus risk return positioning given low EBITDA and large capex profiles, together with shorter contracts," explains Toor. "Those issues are more of a challenge for us than the size of data centres in the market. In fact, there are opportunities across the size spectrum in Europe."

The energy transition

The other mega-theme that continues to soak up focus and capital for mid-market firms is the energy transition. Returns in the traditional renewables space have come under pressure in recent years, but the investment opportunities continue to proliferate.

"Clearly brownfield renewables has become a commoditised space but you only need to broaden the definition of energy transition slightly to create a valuable proposition for core plus or value added strategies," says Minella. "For example, we recently divested Statera Energy, a company that develops, owns and operates large-scale, grid-connected energy storage and flexible generation assets to EQT. I would add that so far, the focus has been on the greenification of electrons, but electrons account for just 20 percent of global energy. The other 80 percent is molecules. We expect to see a lot more capital flowing in that direction in the coming years."

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>
> **LAURENT CHATELIN**
> **Eurazeo**

Arcus, meanwhile, has invested in a number of smart metering businesses in the UK, which offer long-term inflation linked contracts with energy suppliers and government protection against energy supplier default. “Similarly, we have a sub-metering business which measures heat and water costs in multi-dwelling properties in Germany,” adds Harding.

“While the majority of capital still goes into renewable generation, the energy transition can mean a lot of things.”

For Eurazeo, the solution to making renewables work is once again a build-to-core approach. “We are focused on backing specialist platforms and then growing their asset base through development. There is very little value to be had once assets are in the ground,” says Chatelin, who adds that his firm is also actively looking at biofuels including sustainable aviation fuels, as well as biogas.

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>
> **GIANLUCA MINELLA**
> **InfraRed Capital Partners**

Chatelin is less convinced about the case for green hydrogen, however. “There has been a lot of hype around green hydrogen but I think that is now beginning to ease off as everyone recognises the challenges involved when it comes to transporting such a small and unstable molecule, for example.”

For I Squared Capital meanwhile, the trick to generating alpha in renewables as a mid-market investor is to build in scale while being a local developer. “The only way to be competitive in classical renewables is to scale. The way that we can scale while staying true to our mid-market ethos is through consolidated purchasing,” says Bhandari.

“We buy solar panels in bulk before shipping them to different parts of the world. That way you get the benefit of being a large purchaser without any of the inefficiencies of being a very large player.” ■