KEYNOTE INTERVIEW

Building from the ground up

There are considerable advantages to starting small and then looking to scale, according to I Squared Capital's Mohamed El Gazzar and Harsh Agrawal

Mohamed El Gazzar and Harsh Agrawal, both senior partners at infrastructure manager I Squared Capital, share their platform-building approach, where it's possible to buy in at attractive valuations, before scaling assets organically or via acquisition, and then benefiting from multiple arbitrage at the point of exit.

Leverage in the early stages of development tends to be limited, mitigating exposure to interest rate hikes. It's also possible to cross fertilise sector knowledge, replicating platform growth stories in different parts of the globe.

There are risks, of course, particularly around asset integration, which require careful handling and hands on operational involvement. But the benefits of starting small are still significant, say El Gazzar and Agrawal.

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Q What benefits does a mid-market infrastructure approach offer?

Mohamed El Gazzar: There are a number of benefits, starting with the ability to source deals on a proprietary basis at attractive entry valuations. The mid-market can also provide a superior capacity for value creation when compared to the larger end of the spectrum.

Of particular relevance right now, given the slowdown in realisations across private markets, is the access to liquidity that the mid-market can offer. Our view – the next buyer universe is undeniably larger in the mid-market, which is particularly important for infrastructure assets that are not all well suited to IPOs.

Advantages exist throughout the investment lifecycle, from sourcing, to value creation and ultimately exit. This is why we chose to focus on the mid-market when I Squared was founded 13 years ago and it's why we've remained focused on the mid-market ever since, even while our fund sizes have grown.

Q How can managers maintain a mid-market focus despite AUMs increasing over successive vintages?

Harsh Agrawal: Firstly, we're a global organisation with teams on the ground across North America, Europe, Asia-Pacific and Latin America. This allows us to review a broad cross section of opportunities at any one point in time.

The other way in which we've been able to maintain a mid-market focus is through our platform-building approach.

Platform building allows us to maintain price discipline, entering at attractive valuations and then benefiting from multiple arbitrage, as Mohamed explained. In other words, we buy small businesses at lower price points before scaling them and benefiting from the re-rating achieved when exiting a larger established business.

A platform approach also allows us to deploy capital in a patient manner over time, whether organically or via acquisitions. In addition, we're able to cross-fertilise platforms across geographies. For example, we were able to leverage our experience with cold storage in Europe to start another business in the US with the acquisition of WOW Logistics. We're now also looking at an interesting opportunity in this space in Asia.

I would say that having a local presence and deep understanding of sectors is key in the middle market – this has allowed us to be an early mover in terms of market entry. Our HEXA Renewables platform in Asia was one of the first platforms to move into grid connected batteries in Japan. In the Philippines, we were one of the first foreign investors to invest after new regulations allowed for 100 percent foreign ownership. In addition to platform building, we also make opportunistic middle market investments in sectors that we know well and where we're able to secure attractive valuations. A great example of this is the take private of the global temporary power provider Aggreko.

Q One of the inherent challenges with a platform strategy is integration risk. How can managers manage that?

HA: Integration risk is certainly a challenge, not only with platforms but also with larger transactions. The key is to ensure that you have the requisite operational expertise in-house to deal with those issues. This is why we have invested in a team of 45 full-time operational and value-creation specialists who have developed a playbook around

Q How has the higher interest rate environment impacted platform building?

MG: Many of our platforms are established with relatively small initial investments, which means we typically decide to equity fund much of the early development. That seeks to insulate us from any interest rate spikes in the early stages. Once we've built out the team and grown the platform to the point where it can withstand leverage, we can choose to layer debt on top of that.

Equally, with opportunistic transactions such as Aggreko, we are conservative with leverage. Another example is our acquisition of Arriva, the European public transport provider. In both cases, we were disciplined about the amount of debt used, which seeks to reduce our vulnerability to hikes in interest rates.

these sometimes highly complex integrations. The second essential component is the management team – combining the right expertise and strong alignment is an integral component to success.

MG: There are similarities in the challenges presented by integrations and those presented by carve-outs. We've worked on both around the globe. For example, we acquired Hong Kong-based fibre business HKBN in a complicated carve-out from a major strategic which built a lot of knowledge within the firm. We also carved out the European assets from US-listed GTT Communications in another complicated deal.

Then, in the US, we created TEN, our trailer leasing business, through the amalgamation of four different assets, to create a new integrated business. Having a cohesive vision is important. Aligning incentives is also important. Finally, having a joined-up marketing plan is key. When you're taking multiple different businesses and joining them together, you need to be able to present a united front to both employees and customers. That's equally true with carve-outs. When we completed the GTT carve-out, for example, we rebranded the business as EXA and then began the process of educating the customer base on the newly independent entity. It takes a lot of work but is crucial to the success of the deal.

Q What does value creation look like in a more opportunistic setting?

MG: Aggreko is a great example. This is a business that specialises in providing temporary power. It supplies giant generators to facilities around the world, including industrial customers, data centres and major events such as music festivals. Aggreko was listed on the FTSE 250 for many years, but its share price started to underperform when equity analysts began to overly associate the stock with an exposure to oil and gas. Equity analysts tend to have an aversion to businesses that require significant capex, which Aggreko required to modernise its fleet and so the share price was negatively impacted.

We spent a lot of time developing a thesis and familiarising ourselves with the sector before proceeding with the take private at a significant discount to historical trading multiples. We made some changes to the management team and then set about repositioning the business.

Initially, Aggreko was global, with exposure to many parts of the world which weren't particularly lucrative. We shut down some regional operations and refocused instead on North America and Western Europe.

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>
> **MOHAMED EL GAZZAR**

In the areas of Asia where we did remain active, we focused heavily on managing counterparty risk. In the US and Europe, we positioned the value creation story around the mega-trends of digitalisation, reshoring and the energy transition.

In terms of digitalisation, there's been massive growth in the data centre sector, which Aggreko is ideally positioned to take advantage of. The onshoring of manufacturing also plays to the company's strengths and that strategy has been paying off.

Q What are some of the biggest challenges facing mid-market infrastructure investors today?

HA: One of the biggest challenges involves the scaling up of businesses. That's something that requires a really hands-on approach, which is not for everyone. It takes a certain organisational structure to be able to handle intense operational involvement and value creation at portfolio companies. This organisational design has to be supported by the right kind of culture within the investor, and that's what we have focused on at I Squared Capital to build and continually refine over the past 13 years.

MG: I would add that one obvious challenge is the threat of increased competition. We've been successfully investing in the mid-market over many years, and we certainly anticipate, and in fact are already seeing, increased interest from our peers as a result.

The risk, of course, is that this will drive up valuations. However, we take comfort from the fact that we've built a solid organisation with a conducive culture over the past 13 years, deploying over $12.5 billion in 46 platforms around the world. That gives us a clear first mover advantage. Yes, competition is intensifying, but we believe we're still ahead of the curve. ■