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Riding the rollercoaster

Infrastructure managers are working more closely with management teams than ever before in a market where volatility has become the norm, Amy Carroll writes

Fighting fires has become the new normal. The global covid pandemic brought with it previously unthinkable operational constraints coupled with a supply chain meltdown. In the years that followed, we have seen disruptive geopolitical tensions boiling over into major international conflict on several fronts and, of course, the economic environment is unrecognisable from the pre-covid era, with a potent combination of high inflation and high interest rates.

For infrastructure's value creation professionals, dealing with the unpredictable has therefore become second nature. "The level of volatility we are now experiencing has become the norm," says Dominic Helmsley, head of core infrastructure at abrdn.

"We had the covid epidemic and then the outbreak of war in Ukraine, which impacted energy prices, sparking inflation. That in turn led to increased interest rates and a recessionary environment in most geographies. Now we are seeing further conflicts in Gaza and worrying escalations between the US and Iran.

"Our role as prudent fund managers is to assess the impact of that volatility on an asset-by-asset basis. Some of our businesses were heavily reliant on Russian gas, for example, while others have trundled along, largely unaffected, with long-term fixed rate debt and inflation-linked revenue contracts. It varies. But volatility is the one constant that we all have to deal with today."

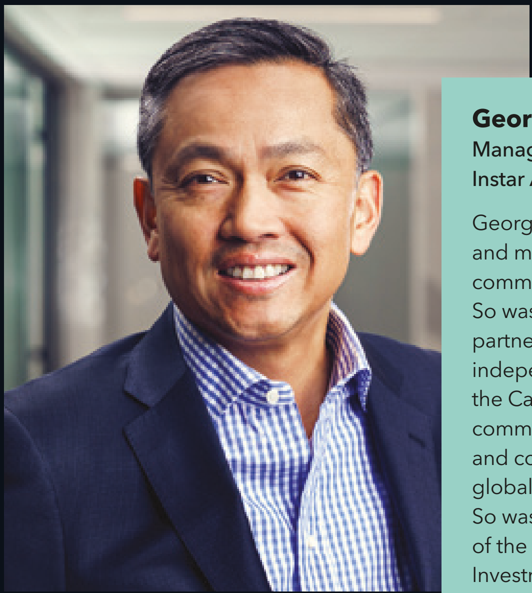
Augustin Schneider-Maunoury, asset management director at InfraVia Capital Partners, meanwhile, says that

Augustin Schneider-Maunoury
Asset management director
InfraVia Capital Partners

Augustin Schneider-Maunoury is a director within InfraVia Capital Partners' asset management team. He sits on the board of several portfolio companies, focusing on procurement optimisation, transformation planning, post-merger integration and organisation design. He also co-ordinates the firm's HR and talent initiatives. Schneider-Maunoury joined InfraVia in 2020 after more than 10 years in strategic consulting.

Dominic Helmsley
Head of core infrastructure
abrdn

Dominic Helmsley has over 30 years' experience in the infrastructure sector, having spent 12 years heading up the international acquisitions group at BAA, and then 18 years in the fund management industry. Helmsley was a partner at Arcus Infrastructure Partners, before establishing the infrastructure team at SL Capital, part of Standard Life Investments. That business now sits within abrdn, following the merger of Standard Life and Aberdeen Asset Management.



George So
Managing partner
Instar Asset Management

George So is a managing partner and member of Instar's executive committee. Prior to joining Instar, So was the founder and managing partner of Kindle Capital Group, an independent investment firm serving the Canadian institutional investment community in establishing syndication and co-investment funds focused on global private equity and infrastructure. So was previously a senior member of the Canada Pension Plan Investment Board's private investment infrastructure team.

managing escalating labour and energy costs have been key areas of focus over the past two years. "In spite of the inflationary environment, 80 percent of our portfolio companies had maintained or improved EBITDA margins between 2021 and 2023. That demonstrates that we invest in assets that are resilient and protected against inflation."

However, Schneider-Maunoury adds that this is also an outcome of InfraVia's active asset management approach: "Over the past two years we reinforced discipline on contractual frameworks to ensure effective inflation pass through. We increased focus on cost control, we worked closely with regulators and we were agile and creative in adapting our business models."

Certainly, active asset management is now more important than ever. The days when it was possible to rely on leverage and multiple arbitrage to generate returns are well and truly over.

"There has definitely been a shift away from momentum investing as the market undergoes a fundamental pivot," says George So, managing partner at Instar Asset Management. "It used to be the case for many that you could invest in a business early in your investment period and make several turns of incremental value a few years later simply on rising multiples. Now that's changed. In an environment of monetary tightening, complicated risks and heightened uncertainty, an active investment strategy, and the ability to tangibly drive value, is essential."

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>
> **DOMINIC HELMSLEY**
> **abrdn**

"We had 10 years of zero interest rates where it was relatively easy to make strong equity returns. That inflated the whole market to some degree," agrees Helmsley. "Five percent interest rates may seem high but if you average it out over time it is close to normal. That is reimposing rigour and discipline around investment decision making and asset management, which can only be a good thing."

A change of emphasis

The nature of proactive asset management is also evolving. "The fundamental value creation levers remain relevant. Helping companies optimise their capex programmes; build-ups and post-merger integration; process and organisation improvement, are all still very key," says Schneider-Maunoury. "But we are increasing our focus on data, digitalisation, cybersecurity, talent management, ESG and carbon performance today."

Helmsley, meanwhile, says abrdn has refined one aspect of its governance, in particular. "We used to be open minded about taking minority positions alongside other institutions, but we will now only acquire controlling stakes. A key learning for us has been that it is a lot easier to actively manage an asset and drive value creation if you are in control and not constantly having to reach a consensus with other stakeholders."

> *"We develop an intimacy with the C-suite, and it doesn't have to be all about committees and reporting. Informal discussions can help you understand what is going on in a business"*
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> **AUGUSTIN SCHNEIDER-MAUNOURY**
> **InfraVia Capital Partners**

abrdn has also increased its focus on talent management. "We have far greater discipline and depth around our approach to people today, both in terms of how we resource asset management teams, and in terms of board effectiveness at an asset level," Helmsley explains.

"We insist on the involvement of experienced non-execs on every investment and we lean more heavily on our senior adviser panel which supports origination, asset management and ultimately exits as well."

Instar also prioritises people and performance. "Our business is and has always been about people," says So. "We've always led with governance, placing focus on people and performance at the corporate level and with our portfolio company management teams with which we are aligned.

"For us, that means having rigour and creating a strong structure, building in committees and partnering with seasoned executives and industry leaders to access deep sector-specific expertise and strategic guidance – from technology to change management – to help our companies to become even better. We have delineated roles for the board and executive management teams, partnering with both to drive value, mitigate risk and create new opportunities."

Close working relationships

Indeed, it appears that sponsors and management teams are working together more closely than ever, something So believes was heightened by the pandemic.

"We have always been an active, hands-on manager with a well-defined playbook, but with the pandemic we further increased the frequency of these interactions. At that time, we set up daily calls with portfolio companies, working closely with management teams to track and reforecast cashflows, which created an elevated level of operational day-to-day involvement. Though it hasn't continued at quite the same cadence, we continue to focus on strategy, communication and engagement to help our leaders stretch and lead their organisations effectively."

Schneider-Maunoury agrees: "In this environment, going over standard reports and a board meeting every quarter, just isn't going to provide you with the grip on the business that you need to understand what is going on, nor the agility you need in order to adjust to that reality and make the right decisions.

"We develop an intimacy with the C-suite, and it doesn't have to be all about committees and reporting. Informal discussions can help you understand what is going on in a business; what the risks and opportunities are and what potential trouble is on the horizon. Being able to talk these things through with management while there is still time to respond, means you can adjust course if necessary. This approach is part of our DNA and it brings value to all parties."

Data and the technology required to make sense of it, has an important

The ESG agenda

ESG continues to be a mainstay of infrastructure managers' value creation agenda, irrespective of the wider macroeconomic context

"When I think about performance metrics, the rigour and asks from LPs have evolved from a few limited questions about our ESG programme to an abundance of detailed questions around areas including biodiversity, social and labour metrics, in a short period of time," says Instar Asset Management's George So. "Though it may initially seem overwhelming, it ultimately creates a symbiotic relationship with our investment partners when it comes to identifying areas to create value."

"Of course, LPs have more ESG reporting demands today," adds InfraVia Capital Partners' Augustin Schneider-Maunoury. "But before being an LP request, it's a regulatory requirement under CSRD [the Corporate Sustainability Reporting Directive] and SFDR. And before being a regulatory requirement, it's a performance pre-requisite. There can be no sustainable financial performance in the long term without a robust and credible ESG approach. If you ignore ESG matters, you will totally undermine customer demand, your ability to attract talent or financing and your ability to find the best suppliers. At the end of the day, financial performance and ESG performance go hand in hand."

However, Schneider-Maunoury says that there is still a lot of work to be done on data quality to improve ESG reporting. "Within a few years, the industry will have to report on ESG with the same level of accuracy as on financial performance. ESG data should be managed in exactly the same way as P&Ls or cash flow statements."

role to play here, too. "We have greater visibility around KPIs today than we have ever had," says Helmsley. "Of course, data analysis helps with that as well. We have become much smarter in the way we look at business performance. It isn't just about the EBITDA line anymore."

The advent of AI

Artificial intelligence marks the next frontier in this journey, but its use is still nascent within the asset class. "Harvesting data through the use of technology has certainly become critical," Helmsley says. "We are able to extract highly specific performance data from individual solar panels, for example, which has been extremely valuable. I can't say that we have a massive tech team working on AI solutions to support better infrastructure investment, but at a local level, we are certainly investing in technologies around data harvesting to inform better decision making."

InfraVia, meanwhile, is taking a very methodical approach to its integration of AI. "We approach AI pragmatically on a step-by-step basis to avoid getting lost in the hype.

"First, we need to make sure that the data foundations of each company are in place. We conduct a data maturity assessment of every portfolio company covering data processes and quality, data infrastructure and data management. Then we identify relevant use cases for our portfolio companies. For instance, in our fibre companies this means prioritising deployment areas, developing an AI-based tool for optimising fibre network design and using image recognition to enhance deployment," Schneider-Maunoury explains.

"Last but not least, we conduct trials at a GP level. We have partnered with data scientists to test and try things at an InfraVia level before we push this to our portfolio companies. AI offers lots of new possibilities, but AI also means more data and more data means more risk. Any exploration of AI needs to go hand in hand with cybersecurity and compliance control."

"Most businesses already use some form of AI," adds So. "We are still in the early phase of generative AI, although it clearly has the potential to be transformative. We are currently focusing more on capacity, productivity and efficiency gains, both from the perspective of internal functions within an organisation as well as the customer service experience. We're also thinking about risk management – intellectual property, confidentiality and privacy of critical information."

But, So says, the conversation needs to be less about AI, specifically, and more about using technology in general as a value creation lever. "Setting up an IT team is not enough. Today, it is important to think about technology as a value driver, rather than as a cost centre. That can help to transform a business."

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GEORGE SO
Instar Asset Management

The end game

This new economic environment, which has been characterised by a steep decline in M&A and depressed IPO markets, has also caused infrastructure managers to re-evaluate their end game, in terms of the emphasis placed on terminal value, as opposed to yield and value creation during the ownership period.

"We invest in businesses with longevity in mind and make investments where it enhances our competitive moat," says So. "As a result, we have always placed emphasis on value creation and making the right investments in people, technology, growth and ESG to drive value, achieve scale and impact and position our portfolio companies for the future.

"That said, with each deal we do, we are thinking about our end goal and exit strategy from the outset. This helps to inform the strategy we put in place for the business, how we want to grow it and how we put ourselves in the best position to maximise value at exit."

Schneider-Maunoury adds: "We are long-term investors, we focus on delivering our value creation plan, through derisking and development – this is fundamental, irrespective of the exit environment.

"We constantly monitor the exit market, knowing that we have the luxury of exiting when the time is right. The priority remains helping portfolio companies reach their full potential."

abrdn funds, meanwhile, have historically targeted roughly half their return through yield at a portfolio level. "Obviously, it varies from asset to asset. Some assets are slower to start yielding. For example, rolling stock doesn't generate much yield in the manufacturing phase but once in service and under lease, it generates yield in the high single digits," says Helmsley.

He adds that abrdn is now considering a less rigid approach. "In my experience, demand for yield varies significantly depending on the underlying investor. A lot of Korean and Japanese insurance companies are hungry for yield, while others are more interested in total returns. Our first two funds had specific yield targets.

"Going forward, we will still target a cash yield, but we may be less explicit about the quantum involved, given that we now have a demonstrable track record in that area." ■