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# Mid-market poised to ride turbulent times

*Mid-market businesses face some unique challenges in the covid-19 era. Three industry experts tell Zak Bentley why they are confident it can grow from the crisis*

As our mid-market roundtable takes place at the end of July, we stand at a bit of a half-way house. The roundtable is being conducted over Zoom – as is usual these days – although two of our three participants are logging in from their previously abandoned offices. In the wider world, several countries seem to be at the end of the first wave of the coronavirus, while not yet officially declaring new upticks in cases as part of a second wave.

What then of infrastructure, the asset class that prides itself on being largely uncorrelated to GDP?

Two weeks prior to our roundtable, *Infrastructure Investor* published its H1 2020 fundraising figures, revealing \$56.8 billion raised by unlisted, closed-end funds – the strongest H1 collection since we began recording in 2008 – with an average vehicle size of \$1.9 billion. And just two days before our roundtable, Antin Infrastructure Partners

**\$1.9bn**

Average size of funds closed in H1 2020

**26.5x**

EBITDA multiple for acquisitions of telecoms towers

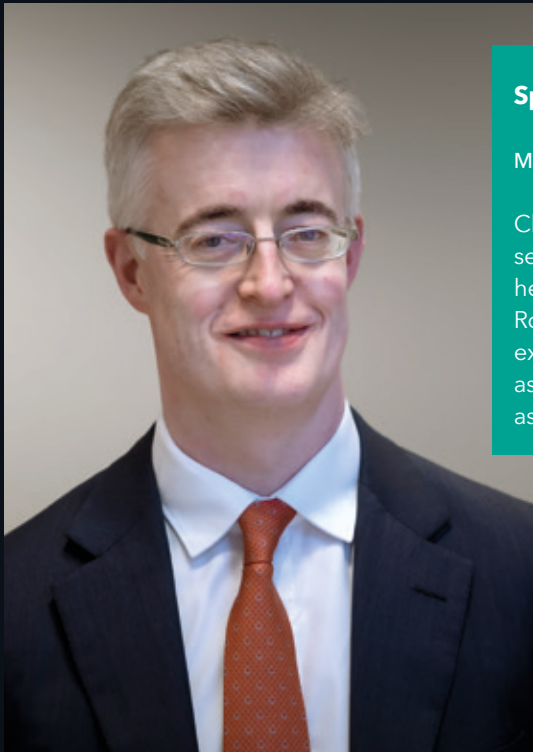
**28.3x**

EBITDA multiple for acquisitions of data centres

closed its fourth fund on €6.5 billion, the second-largest close of the year to date, with about €3 billion raised since the height of the pandemic.

It was a resounding vote of confidence for the manager, which closed its first mid-market vehicle on €1.1 billion in 2010, also in the middle of a crisis. Antin's track record certainly helped this time around, according to Nicolas Mallet, partner at the French firm. Encouragingly, though, he does not rule out newer entrants making plays into the mid-market, even now.

"I feel that a lot of LPs have in the last few years tried to reduce the number of GP relationships they have," he says. "So, I think even before covid, there was a trend to favour existing names. Does that mean we wouldn't be able to do it today [if we were a first-time fund]? It would probably be more difficult, but I don't think it would be impossible, especially in the mid-market, where I think it is less crowded for funds around



### **Spence Clunie**

Managing partner, Ancala Partners

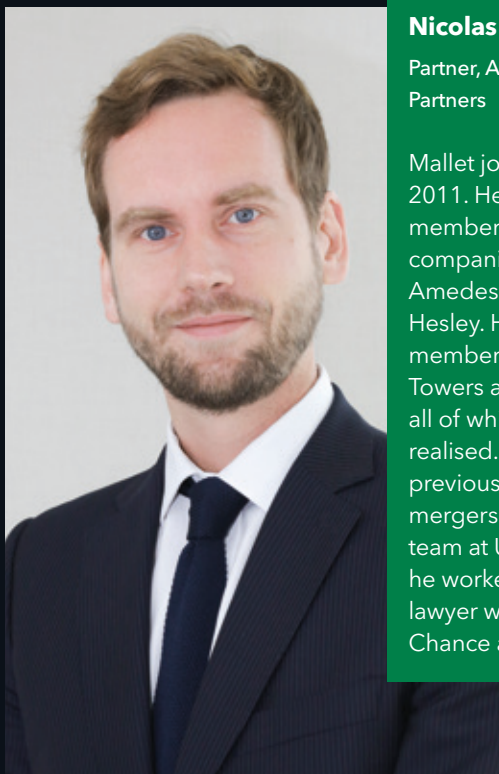
Clunie founded Ancala in 2010 following five years as a senior managing director at Macquarie. He previously held roles at Dresdner Kleinwort Wasserstein and the Royal Bank of Scotland. He has more than 25 years' experience investing in and managing infrastructure assets. He has led Ancala on transactions in sectors such as utilities, bioenergy, hydropower and gas pipelines



### **Oliver Schubert**

Senior partner, Vantage Infrastructure

Schubert leads Vantage's equity investments origination and execution team. He has been with the firm since April 2018, when Hastings Fund Management's European team was bought by Northhill Capital. He joined Hastings as an executive director in 2012 and was a member of its executive and investment committees. He was previously a senior vice-president with Macquarie in Germany



### **Nicolas Mallet**

Partner, Antin Infrastructure Partners

Mallet joined Antin in 2011. He is a board member of portfolio companies Inicea, Amedes, Kisimul and Hesley. He was a board member of Pisto, FPS Towers and Bina Istra, all of which are now realised. Mallet was previously with the mergers and acquisitions team at UBS. Prior to that, he worked as a finance lawyer with Clifford Chance and Ashurst

€1 billion. There is right now a market opportunity.”

One manager closer to that ballpark is Ancala Partners – which closed its Ancala Infrastructure Fund II in February on €735 million – though managing partner Spence Clunie is a little more doubtful about the prospects of first-time managers.

“A lot of the LPs were working through their re-ups with their existing managers, and to get their interest one needs to offer something different,” he says. “To do that from the start is hard. I think it’s difficult because you need a track record, a requirement which is likely to become more prevalent post-covid. In downturns, LPs tend to revert to where they feel safest.”

Oliver Schubert, senior partner at Vantage Infrastructure, agrees that managers have to be offering something different in what has become a packed mid-market.

“If you look at successful fundraisings in the mid-market in recent months, it’s a combination of access to dealflow, support by a shareholder or cornerstone LP and quite a clear investment strategy in terms of how fast you can deploy,” he says. “It’s a tough market out there. There are more managers looking for money, but this crisis hopefully shows infrastructure is a resilient asset class.”

### **Bridges over troubled waters**

Tough as the market may be, the old adage that out of a crisis comes opportunity is certainly ringing true for our participants.

“In previous downturns, the mid-market has historically provided opportunities where corporates or larger companies have sold non-core assets,” says Clunie. “We should hopefully see more willingness from large corporates again to sell assets that maybe they hadn’t thought of before.”

*“Some mid-market companies may have less liquidity buffers than large-cap assets. Some assets will also have less geographic or business model diversification, which may make them vulnerable”*

**NICOLAS MALLET**  
Antin Infrastructure Partners

Schubert also believes those opportunities will come. At the same time, he is wary about what the covid-induced interruption means for greenfield projects and how it could impact mid-market businesses generally.

“Even though we saw a slowdown of deals in the first few months of the year, we’ve recently seen a pickup in deal activity in the last few weeks,” he says. “The question is more about how long-lasting this will be. High-growth businesses that rely on capex will have struggled, as many municipalities did not deliver permits to dig up streets

to lay cables or pipelines in the last few months. That might have had a severe impact [meaning] some of the mid-market companies will have to find new ways of managing this crisis and delivering their growth-oriented business plans.”

Mallet is cautiously optimistic, pointing out some potential issues for mid-market businesses if second and third waves become severe.

“Some mid-market companies may have less liquidity buffers than large-cap assets,” he says. “Some assets will also have less geographic or business-model

diversification, which may make them vulnerable. Generally, my conviction is that it's not a question of large-cap or mid-cap, but more about the underlying sectors and sub-sectors."

If there is one sector that has been hit hard by the pandemic, it is airports. Mallet says airports were formerly seen as the "holy grail of infrastructure investment". Clunie should know, as Ancala bought a 45 percent stake in Liverpool John Lennon airport last

September. Despite the difficulties, the manager can see a silver lining in the clouds hanging over the runway.

"Nobody ran a scenario where the whole economy would be shut down for three months. They will be going forwards," he says. "Clearly, there's a downside, such as a covid-like scenario that hasn't been run before that will be factored into what people are willing to pay to invest in transport assets that could be affected.

"One of the reasons we made the investment is that Liverpool airport has a low EBITDA margin relative to other airports. It hadn't done a lot of the improvements other airports have done. We've been able to accelerate the improvements on the cost side to partly offset the effects of covid."

While Schubert notes airports have demonstrated elasticity to shock events in the past, he believes the current crisis provides a much greater challenge. He is also wary of the demand risk that is prevalent in several other sectors.

"This time around it's much harder to predict what the medium- and long-term effects are going to be," he says. "It will be hard to predict what airport slots will be going for in the future, and what revenues you will be able to generate from retail and parking. This should theoretically have an impact on pricing and capital structures, as banks will be more conservative on traffic projections.

"A renewable power asset that has some market price exposure is also, to a degree, demand-based, because a drop in demand leads to lower prices. We've seen power prices fall to historical lows in the last few months, and also pick up again rapidly when economic activity restarted."

Ultimately, as Mallet tells us, sectors such as transport, energy and social infrastructure have all taken on paradigm shifts and set new challenges for how the market invests.

"The impacts we are seeing in the covid crisis are completely new and we need to find a way to move forward and keep these risks more in mind than we ever have," Mallet says. "In transport, when you have two-thirds of the world confined at home, there's obviously not much demand. In energy, lockdown meant a demand shock alongside an oil price war between Russia and Saudi

*"In previous downturns, the mid-market has historically provided opportunities where corporates or larger companies have sold non-core assets"*

SPENCE CLUNIE  
Ancala Partners

Arabia. Since our first fund, we had a thesis around social infrastructure, and, if anything, this crisis has emphasised the critical role of healthcare assets and shed a new light on some of these assets.”

### The digital arms race

Of course, one of the other sectors now forming part of the core infrastructure space is digital infrastructure. Assets such as fibre broadband businesses, data centres and telecom towers have been highlighted during the pandemic for their resilience and a certain degree of future-proofing, with the need for greater bandwidths amid a new era of working from home.

Indeed, Disney+, the latest streaming service on the block, had its launch in France postponed amid concerns about bandwidth capacity at the height of the lockdown period. Antin already owns broadband businesses in Europe and the US, and Mallet predicts greater competition in this area.

“It’s very likely we will have a surge of interest in digital infrastructure,” he believes. “Telecom towers a decade ago were not considered infrastructure. We have seen a lot of telecom operators understanding they have something of value and selling minority stakes to direct investors. Digital will continue to be a sector of favour to investors.”

His counterparts around the virtual table are a little less bullish on the sector, though.

“Time will tell on the rush to invest in digital infrastructure,” maintains Clunie, whose Ancala has made one fibre investment to date. “They need customers to pay for it and people are going to be poorer through this crisis. While I agree fibre networks will be used more, one needs to be very careful about the types of businesses being

invested in – in terms of the demand risk and the price being paid relative to the growth opportunity. We’re cautious in the current market, which is quite hot in terms of prices.”

Data from S&P Capital IQ up to the end of 2019 show EBITDA multiples for fibre infrastructure and broadband businesses at 6.8x. The figures become significantly higher for wireless towers and data centres, at 26.5x and 28.3x respectively. Those multiples are unlikely to fall in the covid era.

“We’ve seen a lot of very small fibre assets created only five years ago and sold on for high prices based on strong growth of market share capture rates and low expected churn,” says Schubert. “If you’ve been investing in the sector for a number of years and you have a good platform to grow from, that’s great. However, I would be cautious about new players created recently on the back of public subsidies. The fundamentals of the sector are here to stay – and the need for connectivity

*“Fibre networks will be used more, [but] one needs to be very careful about the types of businesses being invested in”*

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**OLIVER SCHUBERT**  
Vantage Infrastructure

and bandwidth certainly increased with covid-19 – but that’s not to say that every data centre and fibre asset will be attractive. It’s certainly an attractive sector, but we need to tread carefully.”

#### **Staying relevant**

The main challenge for our participants, though, is retaining the wealth of interest the mid-market has attracted,

at a time when there are more infrastructure offerings than ever before.

“We’ve had conversations with LPs that have been investing with managers that have grown exponentially in size, but the LP’s allocation capacity has remained the same and now they might feel less relevant to these managers,” argues Schubert. “Some want to reduce the number of GP relationships, but

some are looking towards supporting the next generation of managers.”

With the mid-market still relatively nascent in what remains a youngish asset class, Clunie sees its growth coming in tandem with the rest of the infrastructure market.

“Infrastructure is still behind other alternatives and the allocations will grow,” he forecasts. “As LPs get more experienced, they will do what they’ve done in other asset classes and segment what exactly they want from infrastructure. They will look to diversify their infrastructure managers and can get a better return [in the mid-market] than what they can get purely in large-cap.”

With lessons learned from Antin’s recent fundraise, Mallet also foresees infrastructure’s maturity helping it to grow out of the crisis.

“I’m positive about the asset class because interest rates are not going to go up and bonds will remain where they are,” he says. “Back in 2008, a lot of money poured into infrastructure after equities went down and yields compressed, and I think this is going to continue. In 2008 and 2009, a lot of money was moved into alternatives in real estate. I now don’t think real estate will play as big a role as it did then going forwards. As a result, I think a lot of money will come into infrastructure.”

Our first mid-market roundtable last year concluded with a buoyancy that reflected the wealth of interest in this section of the market. This year’s ends with a similar sense of optimism, tinged with some sobriety as to the reasons why there remain significant opportunities.

There is no doubt we remain in uncharted territory due to the covid crisis. But there is also little doubt infrastructure’s mid-market is set to play a leading role in the recovery. ■