

Instar Asset Management

Value investing for long-term impact

A Q&A with Instar's president and CEO Gregory Smith about infra's middle market

Infrastructure investing is continuously changing. During the past few decades, the definition of what is considered to be essential for our communities, economy and environment has evolved. With the pressures of population growth, long-term urbanization, rapid technological advancement and sustainability imperatives as major trends shaping our future, our communities' infrastructure needs are different today and will be again different tomorrow. At the same time, the end of the low interest-rate era is equally challenging managers and GPs to find new ways to underwrite risk and create tangible long-term value. Together, these shifting forces point to the need for a thoughtful and active investment strategy with resilience and longevity top of mind. The middle market, with its historically compelling return profile and scope to realize operational enhancements and growth, continues to present a robust opportunity set.

How would you describe the current dynamics in middle-market infrastructure, and how do these differ from those in other market segments?

We believe the middle market presents a unique opportunity for investors. In our experience, small and medium-sized companies typically deliver stronger returns for investors on a same-sector, same-geography basis compared with larger deals. It is also well-documented that small and medium-sized businesses have a disproportionate, positive impact on economic competitiveness, employment growth and community resilience. For these reasons, Instar has chosen to stay focused on the middle market and become a specialist in this space because it represents the vast majority of our economy, and typically these smaller companies have greater capacity for growth and value creation.

Investing in the middle market is not simply about investing in smaller companies; it is a specialty that lies in identifying new macro trends early on and finding great companies that will leverage those tailwinds, whether they be new technology, climate-change adaptation or changing demographics. The specialty also lies in how we develop our portfolio companies' competitive advantages – especially in the areas of culture, talent and technology – and eliminate barriers to growth and innovation by helping executive teams see the opportunities their business presents. As a manager, we engage deeply in strategy and invest in people, which is the key to unlocking opportunities and really driving for value.

Where are the most attractive opportunities in this space today?

The opportunity in the North American middle market is sizable and compelling. There is less competition and greater potential for strong proprietary deal flow, along with the ability to compete on factors other than price. These smaller businesses are, in many cases, founder-owned and led, so partnerships, culture, and how we demonstrate care and concern for employees are valuable in this niche, sometimes even more so than price.

Compared with the large-scale end of the market, the middle market is more fragmented, and companies typically have more opportunities to grow organically and through new development projects and acquisitions at lower entry multiples. For example, we have completed 31 add-on acquisitions and 40 development projects across our portfolio since inception. Our experience is that smaller companies are typically more flexible and better

positioned to adapt quickly, embrace innovation and capitalize on growth opportunities.

We believe a number of prevalent and emerging themes in our economy and society are shaping investment opportunities right now, including the security and resilience of critical supply chains and transportation networks; the "recycle" and circular economy; food and water safety and security; technology-enabled critical infrastructure; energy transition and alternatives; and social infrastructure that supports essential community services, to name just a few. These themes underline how our communities' infrastructure needs are evolving against the backdrop of geopolitical and economic disruption, the pandemic and climate change, among so many other complexities.

Why is value investing important in today's middle market?

At a macroeconomic level, we are in an environment of monetary tightening, complicated risks and heightened uncertainty. Following decades of low interest rates and lots of liquidity, in the past 12 to 18 months the marketplace has fundamentally pivoted to a new reality we believe will endure for many years to come. Investors can no longer rely on momentum to deliver returns, and value investing is coming to the fore. The ability to drive long-term value comes down to active management, strategic agility, and how we enable and leverage people, culture and technology.

In any economic environment, it is important to remember that infrastructure is fundamentally about people. For us, investing is and has always been about building real and lasting value in a way that sets up each portfolio company for continuing success not only during our hold period, but well beyond. An active-management approach allows us to respond to macro and industry changes and invest in people as enablers of success. Our strategy also ties to our purpose of enriching people's lives, which leads us to act as a partner to our portfolio companies and invest in the right people in the right place at the right time to help future-proof each company. It is incredibly rewarding to invest in and partner with small and medium-sized companies to help facilitate their outsized impact on the economy and within the community.



CONTRIBUTOR

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CORPORATE OVERVIEW

Instar Asset Management is an independent alternative-asset management firm focused on North American middle-market opportunities in the infrastructure sector and other alternative real asset categories. Instar's growing footprint spans North America with a diversified portfolio of companies that deliver essential infrastructure services and value to communities, partners and investors, helping us to fulfill our purpose of enriching people's lives.

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