

KEYNOTE INTERVIEW

Value creation takes centre stage



Infrastructure is entering a period of value investing, where governance, growth levers and operational enhancements are key, say Instar Asset Management's Sarah Borg-Olivier, Minnie Chan and Cathy Xue

As an era of relatively high interest rates has taken hold in recent years, many private markets investors have had to make radical changes to their strategies. So-called 'financial engineering' has become much less viable, and GPs have had to work harder to generate returns for their investors.

Instar Asset Management believes that these macroeconomic changes have heightened the importance of a solid value-added strategy for infrastructure investors. Sarah Borg-Olivier, chief operating officer at Instar, along with Minnie Chan, the firm's chief financial officer, and principal Cathy Xue, discuss what this shift means for

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the asset class and why people are at the centre of value-creation efforts.

Q How has macroeconomic volatility had an impact?

Sarah Borg-Olivier: The era of momentum investing, which was fuelled by low interest rates and continuously increasing multiples, is clearly over. The market has entered a period of value investing, which has always been our strategy. With our focus on the mid-market, you can find opportunities

with lower multiple entry points and there's more potential to compete on factors other than price. We've also found that small and medium-sized companies typically outpace larger companies in terms of growth, profitability and impact; they are the lifeblood of our communities and economy.

Infrastructure, by definition, is something that is essential within the economy or within a community. Given the economic challenges over recent years, as well as demographic shifts, urbanisation and climate change, how we think about 'what is essential' and how we define infrastructure is very different today than it was five or 10 years

ago. It will be different again in another five or 10 years as the concept of infrastructure is highly responsive to the era in which we live and the challenges and opportunities that we face.

Cathy Xue: During these uncertain times, it is important to have a disciplined investment approach. We focus on downside protection during our investment reviews and conduct comprehensive due diligence to understand how a business performs through economic cycles. Clearly there has been a lot of volatility with interest rates, which highlights the importance of a prudent level of leverage. We have a clearly defined and repeatable playbook for how we invest and drive for value.

Q Why is there a growing emphasis on value creation compared to financial engineering in infrastructure?

SBO: If you think about how infrastructure as an asset class has evolved, going back 20 years, it was about projects or individual assets, rather than companies or platforms. Infrastructure has gone from being government-backed or a government-to-business sector, to being a business-to-business sector; it is a completely different universe. We have always seen that potential and taken an active, holistic approach to building value in each business.

For us, financial engineering doesn't enter the equation. We have always believed that generating alpha in a meaningful way is about developing each portfolio company's advantages, including in areas such as culture, talent and technology. When we think about value creation, it's about operational levers, as well as all the other elements that go into making a business more competitive, more resilient and more successful.

We look for businesses with strong cashflows and downside protection along with growth potential. We want to understand why the company needs to exist today, as well as 10 or 20 years



Q How much of value creation depends on getting the right people in place?

MC: People are at the core of everything we do. We do our best to make sure we have the right people in place and ensure they are aligned with our values and business objectives to effect positive change and progress at our portfolio companies. We lead with governance and collaborate with our management teams to earn their buy-in, focusing particularly on the C-suite as we believe the tone at the top drives momentum for the day-to-day improvement and success of the business. We establish a framework for mutual understanding and alignment to drive long-term performance, where our executive teams invest their own capital in the business and work with us to refine or define each company's purpose to connect it to strategy.

SBO: I think a lot about the art of being a successful investor, including skills such as relationship building, emotional intelligence and managing change, which I think is particularly important in the world we live in today. You need to have imagination around what is possible to achieve.

Purpose-driven organisations tend to be more successful, and the ability to bring people together and create alignment around common goals is highly advantageous during periods of change. If you can keep people focused, help them to collaborate and inspire them to see the bigger picture around what the company does for others, that is critically important to executing the strategy and driving value.

into the future. What makes it so integral to its customer? What makes it so critical within a particular value chain?

Minnie Chan: The transformative acquisitions that have taken place across the firm's portfolio point to step changes in the business and multiples, rather than trying to ride the waves. Rather than financial engineering, we look for

opportunities where we can engage in these step changes to drive long-term value for the businesses we invest in. Many of these acquisitions across our portfolio have helped to expand companies into high-growth geographical locations in their industries, reach new customer segments and realise synergies to expand or introduce new product or solution capabilities.

Q How do you put in place governance structures to encourage value creation across your investments?

CX: During the investment evaluation process, we implement a comprehensive due diligence programme, working with a suite of experts who provide functional and deep industry expertise to help us better understand the business, market dynamics and downside protection. They also support us in developing a value-creation plan, even during our evaluation process, to be implemented once the acquisition is completed.

In the initial stage of our ownership, we first focus on setting up the appropriate governance structure to support the long-term growth of the company. We work with independent board members who provide diverse functional and industry expertise – they are typically former C-suite executives themselves or have spent years with key customers or competitors in a given industry – to support us and the management team in creating long-term value. In addition to the cadence of our board meetings, we set up committees that meet regularly and focus on specific matters at each company, including finance, operations and health and safety.

Our pillars for value creation include driving organic revenue growth, optimising operations and enhancing margins of the business. We also explore opportunities for transformative acquisitions, as well as greenfield development projects, which can significantly enhance competitiveness and market dominance and have created a lot of value across our portfolio. Since inception, we've completed 37 add-on acquisitions and 40 development projects across our platform.

Q How does ESG fit in?

SBO: Being thoughtful on ESG factors and understanding what is important to your stakeholders is essential to maintaining a social licence to

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operate. You are only truly successful if you are perceived to be successful by the community and customers you serve. Understanding stakeholder sentiment and staying close to your customers and what they care about helps to deepen and expand those relationships.

We have always focused on operating our businesses responsibly for our

employees, customers and communities. While the terminology around ESG might go in and out of fashion, our approach is about good governance. If you are fundamentally focused on doing the right thing, you will make the right choices for your people and the environment because you are being thoughtful about what you do and how it affects others.

MC: A significant part of ESG is putting people at the core. We have diversity, equity and inclusion practices that help us bring in diversity of thought through different vantage points and break down barriers to innovation and growth, which helps us to make better decisions and enables our people to thrive.

Q How will investment themes evolve?

SBO: The marketplace is constantly evolving with new investable categories of infrastructure: it's a dynamic landscape. You need to follow macro trends over a period of time to be able to choose the right entry point in a particular sector or value chain, while remaining disciplined and true to your underwriting and investment criteria.

As Instar celebrates its 10-year anniversary this year, the mid-market opportunity set is robust and influenced by evolving social, economic and environmental needs.

Transportation infrastructure themes include greater need for supply chain resiliency and adapting to near-shoring and electrification trends. We are seeing more circular economy opportunities, including waste-to-value businesses.

We are also seeing the rise of natural capital, which was not well understood within the context of infrastructure a couple of years ago and sits where real assets and sustainability imperatives intersect. That is a great example of how we are broadening the aperture of what infrastructure is. ■