

Bringing a PE approach to Australasian infra

MDs **Andrew Charlier** and **Paul Foster** discuss Pacific Equity Partners' first infra vehicle, what sets it apart from traditional infra investing and where the best opportunities are likely to be found

Q Why is there an opportunity for a strategy like the Secure Assets Fund?

PF: If you take all the infrastructure transactions that have occurred in the Australia-New Zealand market over the last five years, the vast majority of those, by number, have actually been in the mid-market, in businesses and assets with an enterprise value of less than A\$1 billion (\$711 million; €626 million). When you overlay that with the fact that most of the traditional infrastructure managers in Australia now have a global reach and increasingly focus on large-cap transactions, it creates an interesting space for us to pursue.

We're not looking for traditional core infrastructure assets: we're looking for middle-market businesses that must have two ingredients, and each of those is as important as the other.

Firstly, the businesses must have a set of very secure earnings that we can underwrite to a normal core infrastructure-type return.

Secondly, and just as importantly, there must be an opportunity to transform the operational capability and performance of the businesses in a way that moves returns from the underwritten secure level up to the mid-teens returns that we're seeking. Both sides of the coin must be present or it's not going to be an opportunity for us to pursue with this pool of capital.

AC: When we invest in a business, we spend a lot of time looking at the thesis and how we are going to be able to transform it such that you can achieve a higher return. We've been doing that across industries in



“When we look at infrastructure, we see a lot of funds investing in the core space without the focus on operational improvement” **Charlier**

the leveraged buyout business for more than 20 years.

When we look at infrastructure, we see a lot of funds investing in the core space without the focus on operational improvement. It's that value-add approach that we're applying to infrastructure and infrastructure-like assets.

Q Why is PEP's approach different from other 'hands-on' infrastructure managers?

PF: It's in the DNA of the firm. We play an important role in finding the right management team, supporting them to the outcomes that we sign up to when we build our business plan, and incentivising them accordingly. Origination of investment opportunities and management teams leverage the individual and corporate networks of the entire PEP investment platform, built up over 20 years of successful Australasian LBO investing.

I would suggest that's a little bit different from the experience, approach and skillsets that a lot of infrastructure managers possess when looking to execute on these sorts of investments.

About 40 percent of our LBO deals have been corporate carve-outs. They are complex and require you to set up new business systems and management teams from scratch. Having done 14 such deals over the 20 years of PEP's history, we have a well-developed approach and methodology to originate and execute these opportunities.

We also want to work with the best management teams, so we will pay them private equity-style incentives. We find that is very good at focusing management teams to deliver performance above and beyond the status quo.

Q What has the response been like from limited partners to the Secure Assets Fund strategy?

AC: We're getting interest across the board

and there's been a pleasing crossover of demand from the existing PEP client base, with increased interest from Australian and New Zealand investors.

PF: A big part of our proposition to our LP base is that, both historically on the LBO side and on the Secure Assets Fund side to date, we've been able to deliver substantial co-investment opportunities. That's attractive to many of our investors for whom co-investment is a core part of the structuring of their portfolios.

Q What type of infrastructure assets are you seeking, and do you anticipate coming up against traditional infrastructure investors?

PF: We're pursuing a range of assets so we'll be targeting all the sectors that a diversified infrastructure strategy would be looking at. We are, however, looking for businesses within those sectors that have a different sort of profile from ones that would be targeted in a core or even traditional core-plus portfolio.

We expect the portfolio to end up with between six and eight investments in it, with an average Fund equity cheque of around A\$100 million, plus co-investment from our LPs.

AC: We've also made a very deliberate choice in that it's Australia and New Zealand-focused. This is where our network is and it's where our management team relationships are.

We'll invest to gain control of assets, given the amount of operational change that we want to drive. We're not a small minority or large consortium kind of investor.

Q Talk us through the strategy behind the intelliHUB purchase, the first investment made on behalf of the Secure Assets Fund, and the subsequent bolt-on acquisitions. Can we expect to see more bolt-on activity?

AC: We were aware that the Australian government was about to mandate the use of smart meters, and we knew that these



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Foster

would entail a significant amount of capital deployment. We were also aware, through discussions with the major energy retailers, that they were going to sell these businesses because of those capital demands and because the businesses were non-core for them. So we engaged Origin Energy, which kick-started a process for the sale of Acumen, its smart metering business.

We were then looking for an operational partner so had a series of conversations with Landis+Gyr, as they owned a smart metering business in Australia called intelliHUB. That gave us a substantial head start on the bid for Acumen and we were able to create operational efficiencies by merging it with the intelliHUB business at acquisition.

Those operational efficiencies are material enough to boost the base return, but the real value is in what you grow it into. IntelliHUB's got a long-term set of cashflows that extend to 30 years with Origin and other smaller retailers. There's a big

market opportunity to get further growth on top of that by servicing other retailers, and the business has already added Red Energy and Simply Energy as customers. Beyond that, we see a lot of opportunities to roll out smart gas meters and smart water meters as well as create value for network owners and retailers and their end customers through the development of value-added data products.

We average about four bolt-ons per portfolio investment that we make across buyouts, and we've done three to date for intelliHUB, so we would anticipate more occurring. It's a growing field with benefits to scale.

Q What are the next steps for the Fund and for PEP's infrastructure strategy?

PF: The intelliHUB acquisition is a good example of our investment strategy across sectors. We identify a market-leading platform opportunity, like the Acumen business merged with the intelliHUB business, and then seek to use that platform to consolidate other businesses in the sector by finding attractive bolt-ons such as Metrix, the smart metering arm of Mercury NZ Limited acquired in December 2018.

We think that strategy is just as executable in the infrastructure space as it is in the LBO space.

The pipeline is full and encouraging. We're looking at deals across a range of different sectors and we've been spending time recently on opportunities in the transport and logistics space, as well as other interesting areas such as parking and other parts of the energy sector. We believe there are plenty of opportunities for us to pursue and it's about trying to find the most attractive combination of secure cashflows alongside the operational improvements that we seek to realise. ■

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PEP Secure Assets Fund

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An aerial, black and white photograph of the Sydney city skyline. The image shows a dense cluster of skyscrapers in the foreground, with the Sydney Harbour Bridge and the Sydney Opera House visible in the background. The water of the harbour is visible, and the city extends into the distance under a hazy sky.

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