KEYNOTE INTERVIEW

# Why biggest isn't always best

*The mid-market has become well established, says Tiger Infrastructure Partners' CEO Emil Henry, with growth capital providing an exciting way to diversify risk*

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**Q Infrastructure is an industry dominated by titans. How has the role of the mid-market evolved in an asset class where success is often measured by size?**
Infrastructure as an asset class was born in the mid-2000s and, unlike most other private asset classes, it was almost immediately propelled into the large-cap space – titans, as you say it.

In the history of traditional private equity, mega-firms such as KKR, TPG, Carlyle and Blackstone all took a while to become large-cap players. But that never really happened in infrastructure, which seemed to be all about large-cap from the very beginning.

The quick path to large-cap has created room for some interesting and successful mid-market strategies that operate under the radar, with less competition, providing opportunities to seek strong returns.

I remember a Preqin statistic from around a decade ago, which cited that most of the capital raised for infrastructure had been raised by firms of $2 billion or more. That was telling. It showed that there was a real opportunity in the infrastructure mid-market.

**Q What are the fundamental advantages of mid-market infrastructure investment?**
In my experience, there is less competition in the middle market and that gives rise to more negotiated deals. Also, there is typically a far more acceptable risk-return profile than you find with large-cap due to more rational pricing. Additionally, in my experience, there is more opportunity to add value with middle market infrastructure platforms than there is in buying, say, a gas pipeline that has already been built, an existing utility scale solar project, a toll road or a bridge. Middle-market infrastructure businesses tend to have under-exploited value enhancing opportunities, and smaller organisations can benefit from the operational and strategic input, relationships and access to capital that an institutional fund can provide.

Lastly, there are likely to be significantly fewer regulatory issues. For example, businesses that middle-market firms target

don't involve PPPs. They are less dependent on subsidies. They are focused on market-driven business models and opportunities in the real economy.

**Q Growth equity, meanwhile, is a relatively new sub-sector of mid-market infrastructure. Where does it fit?**

You are right. Growth capital is a new and exciting piece of the infrastructure puzzle and our goal at Tiger is to be the leading provider of growth capital to middle market infrastructure platforms.

A key attribute of growth capital in infrastructure is that a meaningful portion of capital invested is in the form of primary capital to expand or build out assets (rather than as a payment to sellers) and that the investment is transformative in terms of increasing the asset intensity, scale or cashflows. The need for growth capital is being driven by a host of mega-trends like the need for renewable energy, connectivity and data storage, and energy efficiency.

As a middle-market strategy, we seek to avoid large-scale greenfield projects and instead focus on smaller repeatable projects, the incremental expansion of networks, the consolidation of fragmented assets and the construction or expansion of smaller middle-market infrastructure assets – all of which serve an unmet need.

In addition, we think a growth capital strategy diversifies risks. An acquisition of a mature infrastructure asset typically has greater certainty of cashflows in the near term but also has a significant element of valuation risk which can be amplified by leverage and frothy markets. By contrast, a growth investment strategy typically seeks to build assets at cost (rather than paying a double-digit EBITDA multiple) while accepting some level of execution risk.

We think these execution risks are less correlated with the valuation cycles for traditional infrastructure. A growth infrastructure firm's capabilities need to be designed to understand and manage these execution risks, ideally drawing equally on infrastructure and private equity investment experience.

**Q How do sales processes differ in the growth capital space?**

We are often dealing with entrepreneurs who have come from large companies where the platforms were unable or unwilling to support a new or disruptive infrastructure platform. The growth capital space is not conducive to auctions and these deals will often take up to a year of work to come together. Moreover, since the entrepreneurs usually maintain a significant stake, the selection of the best capital partner is usually a key criterion for them, often weighted as much as other economic factors, which is a recipe for enhanced returns.

**Q And what about your interaction with management during the asset hold?**

Obtaining control, as well as industrial expertise, is important to a value-add strategy. We have a stable of operating partners – seasoned, former chief executives – that help us evaluate companies, carry out due

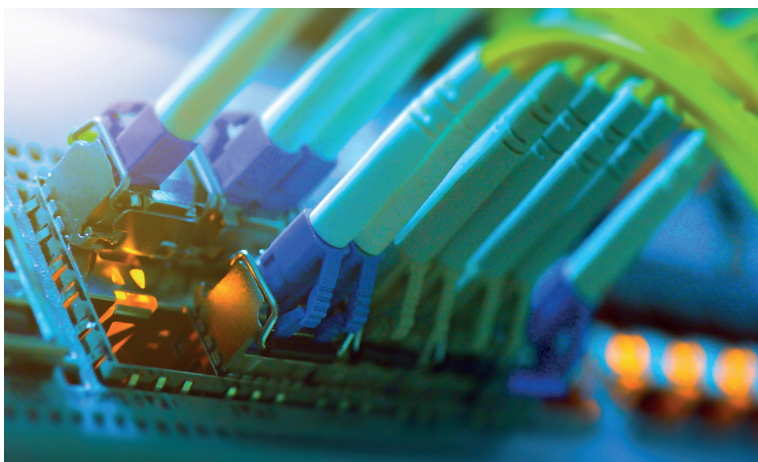
## Growth capital at work

**Tiger Infrastructure Partners acquired a 60 percent convertible preferred stake in a metro fibre company, where a team of entrepreneurs had built out a fibre network connecting all the major exchanges in the New York and New Jersey area.**

The entrepreneurs had built the network primarily by leasing fibre from other carriers. They saw an opportunity to expand the network but needed capital to do it.

In addition to acquiring its majority interest, Tiger injected growth capital into the business to fund this expansion. But instead of leasing more fibre, the firm grew its network connecting key data centres in the New York area and connecting into Manhattan.

The rationale was that in doing so, Tiger would be creating an asset-rich company worth more than a company leasing fibre from others. Having connected Class A buildings throughout New York City, the business was sold as a core infrastructure asset.



*"Growth capital is a new and exciting piece of the infrastructure puzzle"*

diligence, and then actually sit on boards and help run these businesses. Entrepreneurs typically need help hiring key people and in implementing best practices for governance and ESG. They also need access to relationships with customers, vendors, regulators and financing sources – all things that a large-cap infrastructure company will already have in place.

Large-cap investors typically have asset management functions focused on creating operating efficiencies at the margin, maintaining and monitoring discrete assets and avoiding risks. For example, they might buy a big power complex and tweak it to get more efficient output. We believe our level of involvement goes beyond conventional asset management and monitoring, and shares more in common with traditional private equity: we and our operating partners are actively working with our portfolio company executives, making strategic decisions around major initiatives in order to build enduring infrastructure businesses.

**Q Competition may be limited, and auctions rare or non-existent, but there is always someone else with the same idea as you. Who do you come up against in competitive situations?**

We see very little organised competition in what we do. Classic private equity firms typically don't like to build new things – that's not their mandate. Traditional growth equity in private equity is well established, but tends to prefer sectors such as technology, consumer and retail. They shy away from the capital-intensive businesses which, of course, define infrastructure.

Large infrastructure investors, meanwhile, need to write bigger cheques than would be possible in the segments where we operate, and so competition is inconsistent and episodic. We will sometimes come up against family offices because they are looking for higher returns, and they also like owning long-term assets that they can pass on to the next generation. But family offices typically cannot compete with our resources and experience.

Occasionally, we run into a sector-focused private equity investor. But that is rare. What often happens is that entrepreneurs will go to the large-scale infrastructure investors who will tell them they are too early, or too small, and will refer them on to us.

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**Q How would you describe the appetite for the mid-market and for the emerging growth capital space?**

Infrastructure is unusual in that it was, in large part, an investor-led asset class. Interest rates were at historic lows in the mid-2000s and the big institutional investors were looking for yield and bond substitutes. And so, many of these large infrastructure strategies were formed to satisfy that demand by buying large-cap infrastructure.

The space has now evolved to the point where sophisticated investors have been active in the asset class for over a decade. They have built up large portfolios of core assets. And we believe now they are looking more closely at the middle market and growth infrastructure for the merits we have discussed.

I would add that many investors across asset classes have historically sought out the middle market late in economic cycles when competition intensifies and pricing climbs. There seems to be little doubt that we are now in the late stages of a 10-year economic expansion.

There is a lot of cash chasing assets, and, in many cases, the returns don't justify the risks.

In theory, the middle market should perform relatively well in that environment.

**Q So, where are the mid-market and the nascent growth capital sector heading next?**

I believe capital is going to continue flowing into the middle market and, in particular, the growth capital space. Investors will become increasingly comfortable with growth opportunities that they may previously have shied away from due to previously misunderstood risks.

Firms like ours exploit those misperceptions. By providing growth capital, we can take an asset that may not have all the characteristics of core infrastructure at the outset, but when we finish with it, it does.

The punchline is: with growth capital we seek a transformational uplift in value by creating the core infrastructure assets of tomorrow with going concern value. ■

Emil Henry is the founder, CEO and managing partner of New York- and London-based Tiger Infrastructure Partners, a private equity firm that invests transformational growth capital in infrastructure projects and platforms