Arcus Infrastructure Partners

Value creation from active asset management

Recently, **Chase McWhorter,** Institutional Real Estate, Inc.'s managing director, *Institutional Investing in Infrastructure,* spoke with **Neil Krawitz,** partner and head of asset management of Arcus Infrastructure Partners. Following is an excerpt of that conversation.

Neil Krawitz
Partner, Head of Asset Management

Neil Krawitz, partner and head of asset management & ESG at Arcus Infrastructure Partners, was part of the team that founded Arcus in 2009. Krawitz has more than 20 years of experience in the infrastructure and private equity asset classes, and prior to joining Arcus, he was part of Babcock & Brown's European Infrastructure Team and Corporate Finance Team in London. As head of asset management & ESG, Krawitz leads the coordination and best-practice sharing activities with the Arcus asset management teams. He is also the asset manager for Arcus' investment in Alpha Trains, the leading private sector continental European rolling stock lessor.

Tell us a little about your role at Arcus.

My role at Arcus is the head of asset management and ESG, with oversight of our existing portfolio companies. Each of our investments has an asset manager, who is responsible for working in partnership with the executive management teams and creating sustainable value in each portfolio company. My core role is to work closely with all asset managers to ensure that our asset management processes and activities are consistent — a standard, institutionalized framework that is applied across all portfolio companies. I ensure that best practices are shared and help the individual asset managers through specific topics, bringing ideas from one asset to another and from outside our organization in.

Arcus is 10 years old this year. How have you seen strategies in the market evolve in the last 10 years?

Ten years ago, there were fewer investors in the infrastructure space, and people generally looked at the space in a much less specialized manner than they do today. As the sector has evolved, we have seen both an increasing number of players, but also the definition of infrastructure has become broader. As a result, investors have started to segment the way that they think about the market. The market today also includes not just regulated or so-called "core" assets, but also various other types of assets that have protected market positions or that provide essential community services. Consequently, deal flow and also the amount of capital deployed have been growing, which has allowed some investors to focus on the traditional, simpler, core assets at the lower end of the risk spectrum, while others — in particular, fund managers like us — have tended to specialize in the core-plus or value-add subsectors that require higher sector expertise, higher levels of interaction with companies and management teams, and significantly more attention paid to implementation of asset management initiatives. By devoting the associated resources to focus on the European mid-market core-plus or value-add space, we have been able to deliver our investment strategies and ultimately create value for our investors over the last 10-plus years.

Where do fund managers like Arcus find an advantage when the market becomes this competitive?

We are a mid-market, value-add European investor, specializing in three specific sectors: energy, telecoms and transportation. In terms of our competitive advantage, it is really about focusing on investment opportunities in infrastructure sectors that we understand, in European markets where we have experience, and where we can use our asset management expertise to evolve, and ultimately add, sustainable value to our investments. Our business focus is in sectors that have clear, real-asset infrastructure characteristics, but the critical element for our value-add strategy is being able to acquire businesses that can be changed through our active asset management to generate additional return. That includes businesses that have significant growth potential or where we could change or improve management teams or management structures, or where there is an opportunity to potentially evolve commercial strategies, change revenue profiles, optimize and restructure operations and improve capital structures. In short, businesses that require our asset management team's expertise and experience. It is really that "hands-on" approach that we specialize in.

Tell me more about the asset management side.

We focus on three core elements: the people in our asset management teams, the structure of what we do and the processes around how we implement our asset management. Firstly, on the people, we have a combined investment and asset management team, and as a result, the M&A lead from the transaction team, who is responsible for the diligence and presenting the deal to our Investment Committee, will transition from being the M&A lead to the asset manager, post-acquisition. That is a really important piece of alignment of the team over the pre- and post-investment periods as the team that is presenting a long-term business plan to the Investment Committee is then responsible for delivering the plan. It is a key differentiator, because not every manager follows that model.

What about the structure you mentioned?

We have a proprietary asset management framework, which is like a playbook that outlines all our primary asset management initiatives and provides a useful toolkit for our asset management teams to ensure that we have a consistent and repeatable value-creation approach in terms of the activities that we are doing across the entire portfolio. It is used throughout the entire investment lifecycle, from identifying asset management initiatives or opportunities that exist as part of the due diligence, through to the ongoing asset management activities over the business plan period, but also in terms of preparing the business for exit. We devote significant resources to managing our investments and have strong quantitative evidence of the value enhancement, outside of market movements, that our asset management activity has generated over the last 10-plus years.

In terms of processes, we exchange best practices and experience among our teams, ensuring that we are sharing best practice across our entire investment portfolio. For example, every quarter we have a specific but changing topic on which we do a "deep dive" for every single one of our portfolio companies. Each of the asset management teams presents on that "deep-dive" topic to all the other asset managers and the Investment Committee. It's a way of getting "under the skin" of the business into a lot of detail and then sharing ideas. Every year we have two topics that are constant: One is ESG and the other is the annual budget and business planning update cycle for each business. Other quarterly topics vary from things like revenue and pricing structures to strategies on reviews of the cost base to things like employee incentives, IT or cybersecurity.

Could you offer an example that illustrates your value-add strategy?

One of our existing investments, Alpha Trains ("Alpha"), is the largest private-sector owner of passenger train and locomotive rolling stock in continental Europe. Before we started looking at the Alpha transaction back in 2007, key Arcus individuals already had significant rail experience, so we had deep sector knowledge within the transportation space. We had a particular understanding of the fundamentals of the market and financial structures required for the acquisition and developed a long-term strategic plan for what we wanted to change in that business to enhance value.

At the time, Alpha was part of a bigger group called the Angel Trains Group. One of the most important steps that we undertook was the decision to separate the U.K. business from the European business. The U.K. business continued as Angel Trains, and the European business became Alpha.

Although Alpha existed in terms of an operational form at that point in time, all the back-office and corporate functions needed to be set up, as well as holding-company structures, so it was a very significant exercise in carving out that business. It also included significantly changing the mix of the asset portfolio to match what we felt European infrastructure investors needed, appointing a new management team to lead the business, reorganizing the structure of the management team and the corporate structure, and ultimately putting in place a long-term, investment-grade rated corporate debt platform.

Over the last 11 years, we have more than tripled the size of, and equity invested in, Alpha. It has been hugely appreciated by our investors, but also by the company, which now has significant scale, maturity and is the standout player in the European space having benefitted from our dedicated, "day-in" and "day-out" asset management.

What are the main challenges you encounter when implementing this value-add strategy?

Since we are trying to do a lot to evolve and grow the businesses that we own, the most important thing is having the right people in place, particularly as regards the executive management team to deliver and execute our long-term strategic plan. The most important element of that is finding the right way to work collaboratively with each business's management team, who have different personalities, are from different countries and cultures and often from different industry structures. The challenge is tailoring the style and approach of our asset management teams to fit with what is right for that business. Sometimes that means changing the management team, and sometimes it means working with the existing management team but redirecting them such that they are aligned with our long-term vision for the business. In addition, the other big challenge involves achieving a controlling position in the investment. Unless you are in that controlling position, even if you have very good ideas and you have the best intentions, it is quite hard to deliver those changes and implement the value-add strategies that we seek.

Can you quantify the impact of your value-add strategy when it comes to returns and overall asset performance?

For the initiatives that are financially measurable, we have conducted an extensive exercise to calculate that, on average, we have achieved several hundred basis points of return for each investment from quantifiable asset management initiatives — and that is based on initiatives Arcus undertook, excluding any market-driven performance. This is most likely a conservative assessment, because there are some things within the asset management space, such as changes to the management team and the long-term value that that brings, which are aren't easily quantifiable. In short, we are trying to build businesses that have significant scale, maturity, longevity and sustainability — ultimately exiting these businesses at a time where the benefit of having undertaken years of dedicated asset management results in a lower discount rate being applied to the business by the ultimate buyer.

Do you find the enhanced scrutiny of ESG risks and opportunities in the market changing your approach to asset management?

No. It is not changing our asset management per se, because considering responsible investing is something we have always done, even before the term ESG became common vernacular. For us, it is about being a responsible shareholder and corporate citizen, and operating businesses in a sustainable way. And that is something we have done consistently throughout the life of Arcus. We have been recognized as a leader in this area and, in particular, we have achieved first place as GRESB's highest ranked European fund manager for the last two years running (2018 & 2017). Even so, our asset management teams are constantly looking to improve the ESG performance of our investee companies to ensure they contribute to and remain the infrastructure of the future.

CORPORATE OVERVIEW

Arcus Infrastructure Partners is an independent fund manager focused solely on mid-market investments in European infrastructure. By working hand-in-hand with portfolio company management teams, we help to create larger, more resilient businesses that in turn help to meet the infrastructure needs of tomorrow. Based in five different European offices, Arcus has invested over €3.9 billion of equity capital through two funds and four single managed accounts in the last decade.

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