Uncovering hidden potential

A systematic approach to value creation is crucial in the world of infrastructure, and one that will deliver superior performance through the cycles, says CVC DIF's Head of Value Creation **Angela Roshier**

How would you describe CVC DIF's approach to value creation?

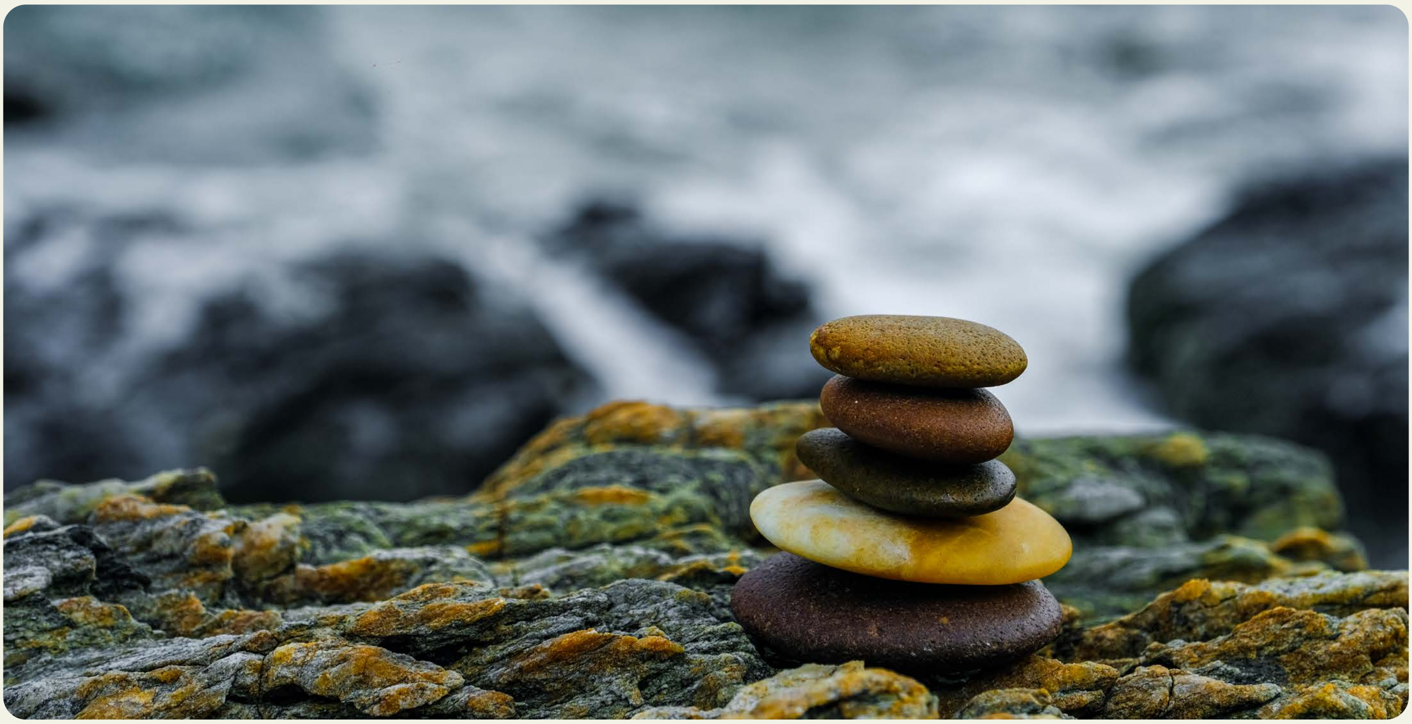
"To be successful – at value creation, as with beachcombing – you need to know where and when to look and which pebbles or rockpools to look in or turn over."

I grew up by the sea in the south of England and so to give you an analogy, I would describe our approach to value creation as like beachcombing. Just as one might pick up pebbles, looking for hidden treasures or items of value, we constantly strive to uncover untapped potential in the mid-market investments that we back.

Furthermore, while the flotsam, jetsam, animals, plants and stones revealed by the beach will differ at different points in the day and particularly in the wake of a storm, so too, the opportunities to add value to infrastructure will change with the cycle and with the inevitable shocks that come our way.

To be successful – at value creation, as with beachcombing – you need to know where and when to look and which pebbles or rockpools to look in or turn over. You need to be able to prioritise your efforts in order to maximise the rewards and that requires a great deal of experience.

At CVC DIF we have been investing in infrastructure for 20 years. We have built a deep understanding of the sectors that we operate in through multiple cycles and across multiple geographies. We have been able to leverage that experience to create a systematic approach to value creation. We have assembled an approach which we apply to every investment that we own in order to unlock value across our portfolio.



What levers form part of your approach?

There are eight key areas of focus. The first concerns de-risking. Our portfolio has a greenfield component and so the management of construction delivery, the robust structuring of contracts and the optimisation of hedging strategies are critical.

Then there is strategic growth. This encompasses M&A activity, as well as organic growth and the recycling of capital. We also spend a lot of time focusing on revenue optimisation, refining sales and marketing processes, building sales teams, segmenting customers and improving pricing strategies. These considerations are particularly pertinent in consumer-facing segments, such as fibre-to-the-home.

Cost management is also an important lever. We focus on optimising capital expenditure, reducing operating costs and restructuring operating models where necessary. Next, I would point to capital structuring. We work hard to support our companies in arranging financing, as well as monitoring covenants and managing working capital.

Another perennial aspect of value creation is talent. That incorporates everything from appropriate incentivisation, board composition and management succession to aligning competencies with value creation levers.

Meanwhile, accelerating the digital maturity of infrastructure businesses is, of course, a crucial component of any value creation strategy. From ensuring the basics are in place with a strong digital foundation and robust cybersecurity, to assessing the potential of artificial intelligence, a continued focus on digitalisation is paramount.

Last but certainly not least, we view sustainability as a critical component of value creation. Sustainability is intrinsically linked to financial benefits such as cost savings, ability to secure contracts and, in many cases due to the fundamental nature of the infrastructure, the businesses' very license to operate.

We leverage each of these eight levers in a systematic fashion in every infrastructure business that we own. This enables us to first identify, then assess, prioritise and sequence the value creation levers at our disposal, ultimately enhancing value at exit and maximising the returns that we are able to deliver to our investors.

> *"Sustainability is intrinsically linked to financial benefits such as cost savings, ability to secure contracts and, the businesses' very license to operate.*

What does being part of the broader CVC platform bring to this value creation strategy?

“Our partnership with CVC has brought considerable advantages, given CVC’s long history of value creation in private markets.”

At CVC DIF we have deep and localized sector knowledge within our sector focused teams, complemented by a network of 12 offices across Europe, the Americas and Australia. The partnership with CVC has expanded this office network, offering even greater access to local knowledge, relationships and deal flow. We have also benefitted from CVC’s expertise in digitalisation, which has enabled us to accelerate our work in this area.

Finally, we have a dedicated infrastructure value creation team, which is something that really sets CVC DIF apart. It is not unusual to have specialist value creation resource in place in private equity, but it is a genuine differentiator in infrastructure. It is also particularly relevant with our mid-market investment focus where the opportunity to create value is often higher: we can leverage aspects of this approach to create value without losing the key infrastructure characteristics of our investments.

How do you work with management teams to deliver on your value creation plans?

It starts before we have even completed an acquisition, although the level of exposure you get to management pre-deal will differ depending on the nature of the transaction. We identify value creation levers as part of our investment thesis and then conduct due diligence based on those assumptions. Certainly, we will have an initial value creation plan in place before we sign.

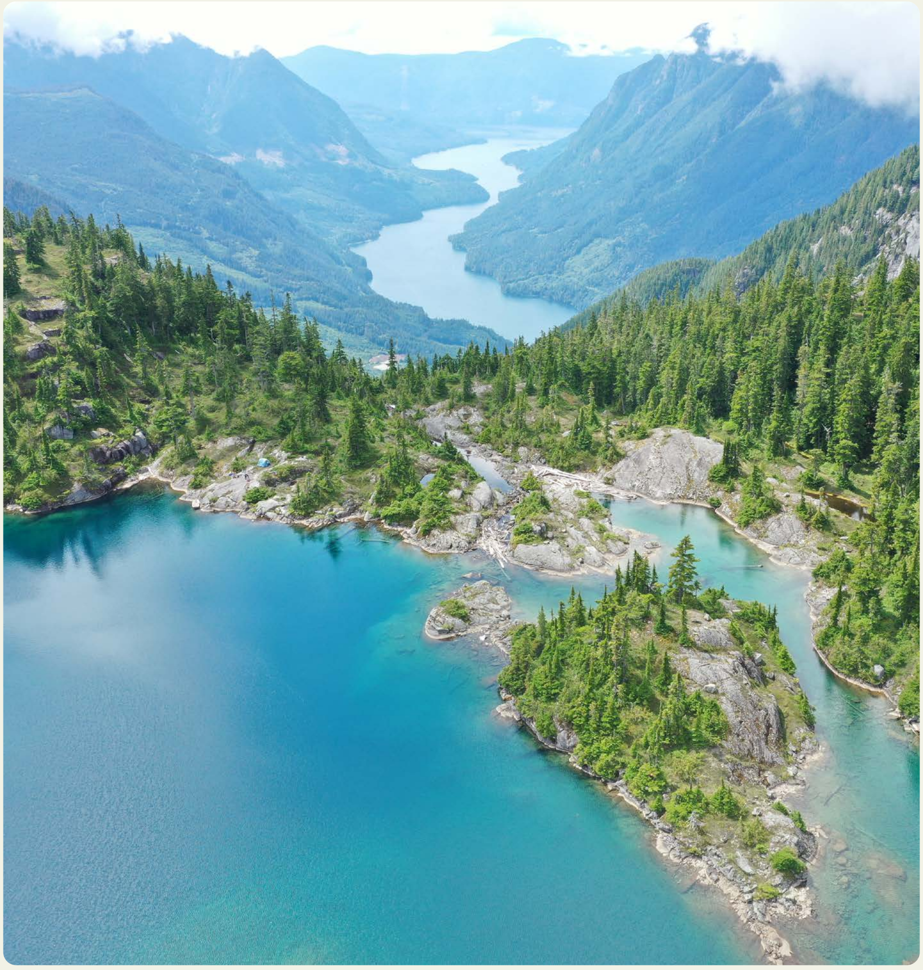
We consider what a prospective buyer would want to see in their own value creation plan and then develop proof points to support this thesis. All of this is done together with the local investment team, management team, our divestment team as well as industry advisers, and the non-execs and chairs of our portfolio.

> *"Progress is reviewed continuously to ensure the value creation plan remains relevant and to determine if change is required.*

It is also important that we are fully aligned with our management teams from the outset. Structuring effective financial incentivisation packages is integral to success. Once the deal has completed, then the real engagement with management begins.

We enter into a structured value creation process, alongside the local investment team, and create a strategy that is aligned with the exit thesis. The focus is always on optimising value at the point of sale. We work through the various tools in our approach, prioritising the most impactful and sequencing planned initiatives with management.

Progress is reviewed continuously to ensure the value creation plan remains relevant and to determine if change is required. Then, two to three years before exit, we conduct the same exercise but with an emphasis on buyer perception.



How can a focus on sustainability lead to value creation?

"There are also opportunities to improve the top line as it becomes increasingly important to have a sustainability angle when bidding for contracts."

I would say that sustainability has a role to play in value creation in three areas. First, sustainability is increasingly influencing our investment theses. Clearly, there are sectors that pose a stranded asset risk today, most notably those with exposure to fossil fuels. We are always considering the exit scenario from the outset. Equally, when assessing an opportunity such as EV charging, we are having to take a view on the trajectory of the transition to electric vehicles. More and more, sustainability trends are intertwined with investment assumptions.

Second, we are focused on identifying value creation opportunities presented by sustainability within the businesses that we already own. This may involve cost reduction. For example, we own motorways, and we have made significant savings through the implementation of LED lighting.

There are also opportunities to improve the top line as it becomes increasingly important to have a sustainability angle when bidding for contracts. I am on the board of Fjord1, the leading ferry company in Norway. Having a clear route to electrification has been critical for Fjord1 when winning new contracts.

Meanwhile, sustainability has implications for the cost of capital. Increasingly, we are being offered preferential margins on our own financing, as well as that of our investee companies, if we are able to achieve certain sustainability goals.. We need to view our actions through the lens of enhancing value over the longer term so, regardless of the current sentiments on the topic, our belief is that a credible decarbonisation pathway is key to optimising the investment's value at the end of our hold period.

Have you had to change your approach to value creation to reflect a more volatile macroeconomic environment?

Going back to my earlier analogy, any big storm is likely to result in a lot of debris. Our job is to sort through it all to find the opportunities and hidden gems that will create value, whilst also taking necessary protective measures.

That said, I don't think a change in the macroeconomic environment necessitates a change in approach. It simply requires a shift in emphasis. Afterall, our approach has been developed over a very long period of time and there are few challenges that we have not seen before.

We worked with portfolio companies facing supply chain issues during Brexit before those same challenges arose during Covid. We have seen price spikes as a result of volatility in the energy markets time and again. Our motorways experienced revenue hits stemming from a dramatic reduction in traffic during the pandemic, but this is something I had seen before, working in the airport space following September 11.

Our experience and the versatility of our toolkit means we are adept at working with whatever shocks come our way and there are always measures that we can put in place. A spike in energy prices following the outbreak of war in Ukraine, for example, meant we focused a lot on energy use and prices, both to reduce costs and protect procurement. Equally, we saw this period as an opportunity to reduce operating costs and enhance the sustainability agenda for some of our investments. Our district heating supplier in Finland, Loimua, for example, is investing in heat waste projects to reduce biomass dependency both reducing costs and carbon dioxide emissions.

In addition to macroeconomic volatility, geopolitical considerations are also becoming more important to our investment theses. For example, we need to take a view on how trade negotiations are likely to play out and what that might mean for various sectors, such as the stance the US President may take on renewables.

It is important to remember, however, that we aren't only facing a period of economic and geopolitical volatility, we are also in the midst of a period of exciting technological advancement. AI, in particular, has huge potential benefits for infrastructure and we are evaluating opportunities to use AI to unlock value across the portfolio. This is a new and powerful value creation trend.

> *"Our experience and the versatility of our toolkit means we are adept at working with whatever shocks come our way and there are always measures that we can put in place."*

How has CVC DIF's approach to value creation impacted the performance that it delivers to investors?

"We know the coastline and the beaches well and are ready to find and unlock potential."

With over two decades of track record behind us, we can clearly see how the action we have taken in each area of value creation has impacted both realised and unrealised returns. There is absolutely no doubt that there is a strong link between these value creation initiatives and the performance we are proud to deliver to investors. As an institution, we have the benefit of a wealth of experience as mid-market infrastructure investors which allows us to navigate, identify and prioritise the levers systematically allowing us to unlock the value across our portfolios. This expertise gives us the confidence that we will able to continue to deliver our track record going forward. To go back to the beachcombing analogy, we know the coastline and the beaches well and are ready to find and unlock potential.