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# GIP's Bayo: Run it like a great business

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*Adebayo Ogunlesi sat down with us at our Berlin Global Summit to talk about GIP III's record fundraise, the firm's operational focus, its one significant misstep and why everything it owns is for sale.*

In a way, we are all living in Adebayo Ogunlesi's world. No, that is not because Global Infrastructure Partners 'invented' infrastructure investing (that distinction belongs to Macquarie), but rather because GIP has become the quintessential infrastructure GP. Founded by 'Bayo' – a 23-year Credit Suisse veteran who left as vice-chairman and chief client officer of its investment banking division – Matthew Harris (also ex-Credit Suisse) and GE expert William Woodburn in 2006, GIP is the manager all other infrastructure managers want to be: independent, industry-leading and able to raise phenomenal amounts of capital.

It took the New York-based firm little more than a decade-old track record to raise $15.8 billion for what is now infrastructure's largest-ever unlisted fund, closed this January. In comparison, the biggest fund in real estate, an older and much more established asset class, closed in late 2015, coincidentally also at $15.8 billion, but was raised by private equity behemoth Blackstone. That this relatively young, independent outfit managed to pull this off in a much shorter time frame is simultaneously testament to its reputation and the incredible investor appetite for infrastructure we are currently witnessing.

But GIP's success is also testament to the power of a deceptively simple idea: that infrastructure assets are to be treated as businesses ripe for operational improvements, instead of bond-like investments to be bought and left on the shelf.

## THE A-TEAM

"When we started GIP in 2006, our theory – and it was really just a theory at the time – was that if you applied industrial tools and techniques to the management of these assets, you ought to be able to make significant improvements to several areas," Ogunlesi recalls.

That was not the prevailing mentality at the time. The received wisdom was that infrastructure assets ran themselves; that they were immune to economic cycles; and that they generated strong cashflows and dividends. In short, it was the "buy it and it forget it" approach, as Ogunlesi remembers one competitor putting it.

Some of the owners of these assets were also strikingly nonchalant about the people they served. UK waste management company Biffa, one of GIP I's investments (and a rare failure, but more on that later), called its customers "debtors". As Ogunlesi deadpans it: "When you call your customers 'debtors', it's unlikely you're thinking of customer service."

So when GIP came on the scene with its bag of tricks and a team full of GE and Honeywell alumni, it made sure customer service was up there with improving operational efficiency, optimising capital spending and more banal things like better cash management. What it quickly found with its first investment – London City Airport (LCY), now exited – was that a focus on customer service went hand-in-hand with operational improvements.

"One of the first issues we discovered at LCY was that they were losing bags – even though 80 percent of the people that use LCY are business travellers that don't check in bags," Ogunlesi explains. Intrigued, GIP sent GE veteran and team member Scott Stanley, who previously ran an automobile parts manufacturing plant, to find out about LCY's lost-and-found problem. LCY's management was equally intrigued at what a "factory guy" could do to solve their lost baggage situation. The baggage handlers at LCY, however, were astounded when Stanley – a 6ft 2in (1.88 metres) American and the first member of their new owner they had ever seen – took off his jacket and jumped into the baggage haul.

Not long after, Stanley called Ogunlesi to say he'd solved the problem. "I thought he'd found some fancy industrial tool – like Six Sigma – but he had done something much simpler. At the time, LCY had 14 gates and they had 12 baggage carts [serving them]. They were loading bags on two planes using one cart, which means bags meant for Geneva frequently ended up in Zurich. Scott's solution was to spend £2,000 to buy two new carts so each plane had a dedicated cart and no longer lost its bags. And because you didn't have to move the bags sequentially, now the turnaround time was actually faster. In the end, we improved both baggage performance and turnaround time," Ogunlesi explains.

Another example was take-offs and landings. "When we bought Gatwick, it was the busiest single-runway airport in the world, processing 50 take-offs and landings an hour. We had two of our guys do a study of Gatwick's air traffic control system and they told management they could increase that number to 55. Even though management at Gatwick is actually quite enlightened, they thought it couldn't be done. We are now at 55 movements an hour and we think we can get to 58. And we got there simply by changing the

sequencing of how you move planes through airports and taxiways and I think we spent less than $1 million in capex to do that.

“Of course, five extra movements an hour at peak times (three hours in the morning and three in the afternoon) is 30 movements, each of which is worth about £1 million. You multiply that by any multiple you want and what you get is hundreds of millions of pounds of incremental value. You’re not firing people or anything like that – you’re just making the place more efficient,” he concludes.

Ogunlesi estimates that GIP has obtained on average an extra 250-500 basis points per investment just by managing these businesses more efficiently. And if you’re wondering whether this kind of operational management works in more prosaic assets than airports, the answer is yes, it does.

“The first power plant we ever owned was a co-generation plant in Houston called Channelview, generating steam and electricity. You look at a power plant and you think: how can you bring operational efficiency to it? After all, electrons do what they’re told and there’s only 20 people working at the plant,” Ogunlesi says.

“The first month that we owned it,” he recalls, “we went to the steam offtaker and said: ‘Look, we’ve read the contract and you’ve actually been under-billed by the past owner by X million dollars a month, so we’re going to change the billing and we’re going to be sending you the bill for the extra amount going forward.”

Next, GIP brought in a “master black belt in strategic procurement”, a former GE employee who pitched himself thusly to GIP and landed a job on the team. Deployed to see how he could improve Channelview, he set about implementing a number of changes.

“This power plant had something like $50 million of EBITDA a year and its second-largest cost centre – after natural gas, which was the feedstock – was the maintenance contract. So, the black belt in strategic procurement looked at the long-term service agreement and he basically renegotiated it with the same supplier, but cut about 25 percent of the cost and got much better terms. That generated a saving of about $9 million a year,” Ogunlesi says.

It turns out the plant’s tax situation was also irregular, in that it was paying higher taxes than neighbouring plants. When the black belt took that to the county authorities, he shaved circa $1 million from the plant’s annual tax bill.

“When you add up the number of things this guy did, I think [he saved us] about $11 million a year in fixed costs. At a 15x [sale] multiple, that’s about $165 million of value – that is a master black belt in strategic procurement creating value and that’s huge,” he says.

## WHEN THE WASTE HIT THE FAN

What all that operational expertise cannot do, however, is save you when things go wrong – or when the fundamentals of an investment are not quite there. That, in a nutshell, is the story behind GIP’s ill-fated Biffa investment, which Ogunlesi candidly calls “a disaster”.

With Biffa, GIP sought to capitalise on an EU-induced regulatory shift that forced the UK to stop disposing of its waste in landfills and move to alternate means of disposal, like waste-to-energy plants. Biffa, a firm with three business streams – industrial waste collection, landfills and waste-to-energy plants – seemed well-

poised for that.

“The [investment] thesis was that we would take all that waste stream and use it as feedstock for waste-to-energy plants as well as anaerobic digestion – in fact, we built the largest anaerobic digestion plant in the UK – and initially all was going well,” Ogunlesi recalls.

The problem is that Biffa was vulnerable in ways GIP did not initially spot. To start with, Biffa was not really a monopoly and as GIP went on to discover, barriers to entry in the garbage-collection sector were low. Secondly, because Biffa was collecting industrial and not residential waste, it was uniquely susceptible to the 2008 financial crisis.

“If you think about industrial waste collection, the two largest customers are construction companies and restaurants. What happened during the financial crisis? No more construction and people didn’t eat out anymore. So, we had falls of 15 to 25 percent [in garbage collection], the company had to go into administration, and we lost that investment.”

That rare misstep taught GIP a couple of valuable lessons: one, do not invest in businesses without high barriers to entry; and two, avoid companies in transformation, because there are lots of outside factors that escape your control.

## SIZE MATTERS

What Biffa did not do was make much of a dent in GIP’s track record. Ogunlesi points out that GIP I’s gross IRR “is just higher than our 15-20 percent target, whereas GIP II’s is substantially higher”.

Obviously, you do not raise infrastructure’s largest-ever fund without best-in-class performance. A less obvious question is why GIP decided to size Fund III at $15.8 billion – was it just because it could?

“We size our funds to the investment opportunity as we see it,” Ogunlesi answers. “GIP I was $5.64 billion and quite frankly that was the largest amount we felt comfortable investing for a first-time fund. When we raised GIP II, we had the advantage of having done several successful investments in GIP I (aside from the loss of Biffa) and we also had the advantage of having been able to demonstrate the value creation from these operational improvements and our strategic joint venture approach, since five of Fund I’s 12 investments were made through JVs.”

But Fund II’s $8.25 billion ended up being invested much more quickly than the team expected. In retrospect, Ogunlesi acknowledges Fund II could have raised $10 billion or $12 billion when it closed in 2012, had GIP not turned down LPs for fear of how long it would take to invest a larger amount. As it happens, seven out of GIP II’s 12 investments were also done as strategic JVs.

That informed GIP’s thinking around Fund III’s target. “We think the [investment] environment looks very good. Commodity and energy prices are down, the shipping industry is in the doldrums, and that’s created a very good opportunity for doing strategic JVs with the kinds of partners we want, be they energy, transport, mining, or industrial companies. All these companies have infrastructure assets, but they now are focused on improving their returns on invested capital, so the opportunity to do a JV with us for one of their infrastructure businesses is very attractive to them,” the GIP chairman asserts.

That allows GIP III to write sizeable equity cheques, especially once you factor in co-investment. “Between GIP III and our co-investors, we can probably write $5 billion equity cheques; probably even $10 billion, if we had to, because our co-investors are all world-class institutions that want to put money into infrastructure as an asset class,” Ogunlesi says. That is a world away from the biggest equity cheques GIP wrote out of Fund I and II, which amounted to $700 million and $2 billion, respectively, the latter factoring in co-investments.

It also allows GIP to avoid competition and get a foot in the door with some of the companies it wants to partner with. “I often joke that if you go to one of the oil majors and tell them you can invest $500 million, they’ll tell you to go meet with the janitor – if you’re lucky. If you go to them with a cheque of between $2 billion and $5 billion, you at least meet the assistant treasurer, maybe even the chief financial officer. The fact that we can write those large cheques means we can do things that are actually consequential for these bigger companies.”

A COSTLY EQUITIES PLAY?

The big question as GIP deploys ever larger equity cheques is: can it keep deploying the same kind of operational transformation that is its hallmark? In this context, it is fair to say that GIP III’s first investment – the purchase of a 20 percent stake in listed infrastructure firm Gas Natural – raised more than a few eyebrows. After all, what is one of the most expensive infrastructure managers doing buying shares on the open market?

“We see, notwithstanding the performance of the stock markets, that there are some assets that are undervalued in the listed markets,” Ogunlesi answers. “We think Gas Natural has fabulous assets [and] we think the market undervalues them, so our task is to work with management and our other JV partners – La Caixa and Repsol – to demonstrate the value those businesses have.”

Of course, the follow up to that is: how much value can GIP really add as a minority stakeholder? After all, the changes described earlier to LCY and Gatwick were done with majority holdings. With Gas Natural, GIP gets to nominate three board members, Repsol appoints another three and La Caixa gets to choose four and nominate Gas Natural’s chairman. With that in mind, why not take a larger position?

“We don’t think we need to own more than 20 percent to achieve what we want to and we’d run into concentration risk for a larger stake, because don’t forget we’ve invested quite a large amount,” Ogunlesi argues, referring to the $2.5 billion in equity GIP and its co-investors spent acquiring their position.

Part of the reason for that confidence, though, comes back to GIP’s track record. “When you do JVs with industrial partners you have to be very careful because people are justifiably proud of their operations. But some of them come to us because they recognise that, having run these businesses as cost centres, they haven’t run them as efficiently as they could’ve and they are looking for our ability to help them improve their operations,” Ogunlesi explains.

It is also for that reason that, notwithstanding its swoop for an undervalued Gas Natural, GIP does not shy away from paying a high price if it deems an asset worthy. “Here’s what we’ve found: you are much better off paying a higher price for a higher-quality asset than paying what you think is a great price for a lower-quality asset. That’s been our experience. The investments where we’ve done the best, even if we had paid 25 or 50 percent more [than we did], we would have still made a great return,” Ogunlesi explains.

## ‘EVERYTHING WE OWN IS FOR SALE’

With such a strong focus on operational improvements, does GIP ‘exhaust’ the assets it invests in, leaving no room for further improvement? EQT Infrastructure, for example, another well-known value-add investor, times its exits according to its “full-potential plan”: “We ask ourselves: ‘Is there more gas in the tank or is it time to start to exit?’ Sometimes that takes seven years, sometimes it takes three and a half years,” head of real assets Lennart Blecher explained in our April keynote interview.

Ogunlesi has a different view. “We don’t actually look at it in that sense, i.e, we’ve done all the improvements and now it’s time to leave [because] the thing about these assets is you’re never done. That’s another mistake we made when we started GIP. We thought the team would come in, do two or three things to ‘fix’ these assets in a few years and then we’d be off to the races. We bought Gatwick in 2009 and eight years later we are still finding things to improve. We bought LCY in 2006 and sold it in 2015 and there are still things you can do to improve it.”

LCY’s sale is a case in point. On the face of it, the £2 billion ($2.5 billion; €2.4 billion) exit to a consortium of Canadian direct investors – at an alleged 28x EBTIDA multiple – raised questions as to what kind of growth the new owners would have to achieve to get a decent return on their investment.

“It’s not what you pay for an asset, it’s what you are ultimately able to do with it,” counters Andrew Claerhout, the head of Ontario Teachers’ Pension Plan’s Infrastructure & Natural Resources Group and a member of the LCY buying consortium.

“We were able to understand that well due to our airports experience and we were able to underwrite some of the risks that were involved in LCY’s airport development plan, which has now been approved by the Secretaries for Transport and Communities and Local Government,” he explains, referring to the £344 million plan green lit last summer, which should allow for an extra 32,000 flights by 2025.

“We thought the plan had a high probability of being approved,” Claerhout continues, “and post-approval, we think there is room for growth in the airport by increasing its aeronautical and terminal capacity. There’s going to be a lot of capital spending going into LCY to make it bigger and better and we feel quite optimistic about its future.”

Ogunlesi concludes: “When we make an investment, our typical expectation is that we will hold an asset for five to seven years – we won’t sell the next day. However, we are quite opportunistic sellers. Each time we review an investment, the team has to justify why we should continue to own it, because if we are not selling, then we are underwriting it at the current value. At the end of the day, we are a finite-life fund – everything we own is for sale.”

## Fixing US infrastructure

By now, it should be well known to most in the infrastructure industry that Adebayo Ogunlesi is a member of the President’s Strategic and Policy Forum, a 16-member council of ‘wise men’, chaired by Blackstone co-founder Steve Schwarzman, that is advising US President Donald Trump on how to create jobs and spur economic growth. Other business leaders in the forum include BlackRock chairman Larry Fink, JPMorgan chief executive Jamie Dimon and former SEC commissioner and Patomak Global Partners chief executive

Paul Atkins.

Considering all the hoopla around President Trump's proposed $1 trillion infrastructure plan, we were curious to hear of Ogunlesi's vision for US infrastructure. While qualifying that it is still early days for the Trump administration and its infrastructure plans, he offered his assessment of two areas where US infrastructure could improve: permitting and privatisation.

"To build a major project in the US now takes up to 10 years," Ogunlesi says, referring to all the environmental and regulatory hurdles projects have to clear. "Canada does it in two to three years and Germany does it in two — and I don't think any of those countries are any less committed to the environment, or to proper regulation."

Part of the problem, he explains, is that in the US you often have multiple agencies doing the same thing. "For example, the Environmental Protection Agency and the Army Corps of Engineers will, in some instances, both undertake environmental reviews. In some cases, they either don't have deadlines to get the job done or ignore them. And when agencies disagree, there's actually no mechanism for resolving disputes, so the projects get caught in the middle. Then on top of that, you have to layer the state and the municipal reviews and the legal processes.

"So if there's anything encouraging about the direction of the Trump administration it's that they want to streamline the regulatory approval process in the US, which I think is necessary, and I don't think they need to be less concerned about the environment," he concludes.

Then there is privatisation. "In the US, we often hear that the reason we should not privatise is because infrastructure assets are 'strategic'," Ogulensi told a full house at our recent Global Summit, in Berlin. But in the country, the really strategic assets, such as energy and telecoms infrastructure, are all in private hands, he correctly pointed out. "If GIC buys a toll road in Pennsylvania, what are they going to do with it? Roll up the tarmac and leave?" he jokingly asked. "The whole idea sounds silly."

True as that may be, of late there seems to a concerted refrain coming out of the President's Strategic and Policy Forum. In mid-April, BlackRock's Fink said in a television interview: "Fly into London, Zurich or Sydney and you land at a privately owned airport. In the US, by contrast, virtually every major airport is owned by a government entity."

In our conversation, Ogunlesi also zeroed in on US airports, and it is not hard to see why, considering the shoddy state of many of them. But of course, this can also come across as self-interested, considering how much private investors stand to gain if the Trump administration were to open up those assets to private ownership.

However, the GIP chairman is quick to point out that of the 27 investments GIP has made to date, only three have come from the public sector. He also stresses that, even though the US is GIP's main investment market, public deals would be an additional – not the main – source of deals for GIP III.

"If you go back in history, there were actually a lot of private airports in the US. They became public as part of a deliberate policy: the federal government would only provide grants to public airports, so in the 1930s, they almost all became publicly owned," Ogunlesi says.

Like Blackstone's Schwarzman, who recently said people must realise that privatisation involves trade-offs, Ogunlesi acknowledges that politicians like to be in control of these large assets. But he believes it is also up to the private sector to make a strong case as to why they should be privatised.

"A lot of states and municipalities that own airports view them as self-sustaining, but then they don't pay any taxes. If an airport is privately owned, it becomes a taxpayer. So, when you sell an airport you'll get a tremendous amount of capital which you can then use for other purposes and [you can] then tax them – those are some of the things we need to tell people."

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