

Wastewater into wine

EXIT OF THE YEAR – MID CAP Taking full ownership of EMC Holdings wasn't on Affirma Capital's agenda, but it performed a successful pivot when the business started moving in the wrong direction

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team completed its protracted journey to independence – through a spin-out backed by Intermediate Capital Group – in August 2019. Six months later, COVID-19 was evolving into a global pandemic. Suddenly, investment theses, private market valuations, and exit timelines were being called into question. In this context, a bumper trade sale really helps.

Affirma Capital, as the firm is now known, duly delivered with a KRW1 trillion (\$855 million) exit of Korean wastewater management business EMC Holdings to a unit of SK Group. The investment generated a 14.2x multiple and a 26% IRR.

"This made a big statement as to our ability to deliver outstanding results as an independent platform," says Nainesh Jaisingh, CEO of Affirma. "We are one of the largest emerging markets mid-cap investors. Our business case is that we transform mid-cap companies into national and regional champions, and EMR really validates that."

However, the nature of that transformation wasn't what Affirma had in mind when it invested in 2009. Back then, EMC was owned by a local conglomerate and called Kolon Water & Energy. Affirma paid \$40 million for an approximately 40% stake as part of a reorganization effort.

"We never expected to get control of the company. We thought it would be a pre-IPO investment and when we moved the company from being a subsidiary of Kolon Construction to being a subsidiary of Kolon Corporation [the holding company of Kolon Group, a local chaebol], it was positioned nicely," says Taeyub Kim, head of Korea at the firm.

Bad to worse

Kolon Water first tried to go public in 2014 only to be blindsided by a problem with the underwriter for the offering. Tongyang Securities had been chosen for the role but then went through a restructuring and was acquired by Taiwanese peer, so could not proceed. Kolon Water relaunched the listing a year later only to be thwarted by changes in its own business.

"A new law had been introduced that banned the dumping of sludge [the product of wastewater treatment] in the ocean. You had to squeeze it, dry it and burn it or squeeze it, dry it and bury it. The squeezing and drying required electricity and back then industrial electricity prices were rising because the government was shutting down nuclear power plants. On top of that, there were continuous wage increases," says

Kim. "All three of those cost items were spiking."

Affirma faced a difficult choice: go for an IPO a third time, sell its stake to a third party, or come up with another solution. The GP owned a combination of ordinary shares and redeemable convertible preference shares. It used the latter as leverage, suggesting that Kolon Group might like to sell the remaining 60% – for KRW88.6 billion – rather than honor a redemption.

This decision was in part driven by changes in leadership and strategy. Between 2009 and 2016, Kolon Water had four different CEOs. The most recent appointee embarked on a diversification plan, taking the company into hydrogen fuel cells, nuclear power plant management, and offshore drilling and rig services. Affirma suggested splitting the business in two: it would take the water and wastewater treatment assets and Kolon Group could keep the rest.

Rejuvenation plan

Affirma made few changes to the management team of what was now called EMC Holdings. But the company's systems and processes were thoroughly overhauled. Competition for water and wastewater management contracts is based on bids and counterbids. This dynamic is not suited to the bureaucratic reporting infrastructure of a Korean conglomerate where decisions are often signed off by the chairman. Under EMC's new ownership, bids were approved within minutes, not days.

Meanwhile, EMC addressed the issue of sludge disposal costs by buying its way into the value chain. There were six acquisitions in the incineration and landfill space, including Korea's largest landfill operator and a greenfield incineration and water business. Management was initially wary of this expansion but gradually became emboldened. This filtered through to other parts of the business.

"We encouraged management to do crazier things," Kim adds. "There was a Korean army base managed by a water company under the

Military Mutual Pension Fund. No one thought that anyone from the outside could take that contract, but one of our team said, 'No one is bidding on this, we know the quality of service is low, so why not try?' Amazingly, we won a contract to manage water facilities for the entire army base."

EMC is now a fully integrated environmental services platform with nationwide coverage. It operates 970 sewage and wastewater treatment facilities, four waste incineration plants, one landfill site, and one waste oil refining business.

It ranks first in Korea for revenue from water treatment and third by waste incineration capacity, landfill sales volume, and oil refining sales volume. In 2019, revenue and EBITDA reached \$317.4 million and \$66.2 million, respectively, up 80% and 425% from 2016.

"We changed our mentality from defense to offense. As the management team became more confident, we established KPIs [key performance indicators] with them, and even junior team members started coming up with bolt-on acquisition ideas," says Kim. "Each year, we set out new goals and new initiatives and the company achieved them."

He believes that holding on for a couple more years would have given Affirma an even better return, but the private equity firm wanted to return capital to investors. The exit process was facilitated by the relatively light COVID-19 impact on Korea: there have been no widespread lockdowns and

business activity quickly returned to near normal levels over the course of 2020.

"Had there been any other factors, such as questions about what happens to the business through and beyond COVID-19, that could have been a problem, but waste management is so resilient," Jaisingh explains. "At the same time, there was interest in the asset from global private equity as well as from strategic investors because we had ticked all the boxes in terms of impact." ▀



Affirma Capital's Taeyub Kim

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