

## Affirma's decade-long water turnaround

Having assumed full ownership of EMC Holdings in 2016, Affirma Capital rejuvenated the Korean wastewater management business through savvy acquisitions and encouraging management to get creative

### AFFIRMA CAPITAL'S INVESTMENT IN

Kolon Water & Energy was supposed to be a straightforward pre-IPO deal. However, when the listing failed to materialize, it marked the beginning of a topsy-turvy 10-year journey in which the GP ended up taking control of the Korean waste and wastewater treatment business. An KRW1 trillion (\$855 million) exit to a unit of SK Group was agreed this month. Affirma will secure a 14.2x multiple and a 26% IRR, but these returns were not easily won.

"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, a founding partner and head of Korea at the firm. "We didn't anticipate it would go through so many difficulties."

Affirma – which took on its current name after spinning out from Standard Chartered two years ago – paid \$40 million for an approximately 40% stake in Kolon Water in 2009. The company 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 Taiwan's Yuanta Financial Holdings, so could not proceed.

Kolon Water relaunched the listing effort a year later, once again with Tongyang Securities in tow. This time the problem was the candidate rather than the underwriter: several significant shifts in Kolon Water's underlying business saw it fail to meet budget and the IPO fell through.

"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 major cost items were spiking."

### Stick or twist?

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. It owned a combination of ordinary shares and redeemable convertible preference shares. The private equity firm 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,

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– Taeyub Kim

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.

Kolon Water was renamed EMC Holdings and Affirma got to work. There was only one new face at the executive level. Affirma had known the management team for some years and was comfortable working with them. But the systems and process around these people did change as unwieldy reporting and decision-making infrastructure was replaced by something more streamlined.

"The water business is a bidding process. You must decide how much you want to bid for a contract and then how to respond to other bids. Because Kolon was a chaebol, if the head of sales wanted to invest a certain amount, it had to go all the way up to group chairman level, which took a few days," says Kim. "We changed it to 30 minutes, confirmed through emails, phone calls, messaging."

Meanwhile, EMC addressed the issue of sludge disposal costs by buying its way into the value chain. "I wanted the company to benefit from the trend, not be a victim of it," Kim explains. There were six acquisitions in the incarnation and

landfill space, including Korea's largest landfill operator and a greenfield incineration and water business. Company 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."

### Mission completed

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 addition to central and municipal governments, EMC works with groups such as KCC Engineering & Construction, SK Hynix, Hyundai Steel, and various Kolom Group subsidiaries. Other business areas include construction of water and wastewater treatment plants, build-transfer-operate (BTO) projects, and environmental technology R&D.

Revenue came to \$317.4 million last year, up from \$175.5 million in 2016, the year Affirma assumed control. Over the same period, EBITDA increased from \$12.6 million to \$66.2 million. EMC's order backlog stood at \$1.2 billion as of June, compared to \$838.4 million in 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. Had we held on for a couple of years more it would have been an even better exit." ▀