Cashing in on fibre consolidation

Gillis Cashman, a managing partner at Boston-based private equity firm M/C Partners, talks us through the firm's successful investments in Metro PCS, Lightower and Zayo; and explains why US fibre is set for a second wave of consolidation

Lorna Thornber
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Lorna Thornber: Can you give us a quick overview of the business' background and its focus?
Gillis Cashman: M/C, which stands for media and communications, was spun out of TA Associates about 30 years ago. We started out in radio and cable and then got into the wireless space, really at the applications stage. We were early investors in Western Wireless and Nextel, and were a founding investor in Metro PCS back in 2000. On the fibre side, we were a founding investor of Brooks Fiber Properties in 1993 and since then have founded or invested in 15 or so local competitive carriers.

LT: What is your strategy for investing in fibre, and has this evolved over time?
GC: We play at different stages of the capital structure depending on the industry and macroeconomic cycle.

So in the 1990s, we started a lot of companies. When the market turned in 2001-2002, we did a lot of distressed investment, take privates and restructurings. Dominion Telecom Network, for example, including its acquisition of Telergy had network assets totalling US$1.3bn of investment across the eastern seaboard, but then got into trouble so we bought it for $1m (the next closest bid was sub US$40m), so at the time fibre networks were really viewed as liabilities.

Another example is ICG Communications, a competitive access provider, which had spent US$3bn building out in the 1990s and then went into bankruptcy in 2000 before its takeover by two distressed debt funds. When we saw it in 2004, it was headed back into bankruptcy.

Typically, we build a very specific thesis around a segment and then recruit management to acquire or build companies. We were working with Dan Caruso, who with our partners Columbia Capital we had recruited from Level 3 in 2003, when we bought it for US$8m. It was burning about US$8m a month, had US$35m cash on the balance sheet and US$125m of liabilities. Dan and his team did an incredible job restructuring those liabilities to US$10m and within six months cut the burn rate from $8 million a month to cash flow positive. We scaled it back to focus on fibre and sold it 18 months later in 2006 for $225m.

LT: Did ICG's dramatic rise in value reflect a growing demand for fibre?
GC: In 2006, the market returned to growth, and demand was catching up to supply. When we sold ICG, we realised there were still hundreds of US carriers lacking the capital structure, cash, and balance sheets to invest in their networks.

There was a focus at the time on very quick payback investments, with no one investing to aggressively build out to enterprise buildings, hospitals or towers. So we led the US$185m raise around Dan's management and the formation of Zayo, with a strategy to go out and consolidate US fibre.

We also wanted to provide capital for tower builds, and execute contracts that had three to four-year paybacks, but with customers willing to sign seven-10 year deals. Zayo has made over 34 acquisitions, and went public last year.

LT: You created fibre operator Lightower, which recently agreed to buy Fibertech Networks from Court Square Partners for US$1.9bn. How did you help to grow the company before selling it to Berkshire Partners in 2012?

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GC: We spun Lightower out of National Grid, which divested its telecom assets in 2007. We approached the management and bought out its US tower and fibre assets, and immediately split the business in two. The existing team focused on the tower business and we bought in Rob Shanahan, who we had backed at Brooks Fiber, to run the fiber business.

We eventually sold the towers and used those proceeds to make seven acquisitions, taking the fibre business from around $15 million of EBITDA to $110 million by the time we sold it to Berkshire Partners in 2003.

LT: Where do you think the greatest future opportunities lie?
GC: The opportunity we're in with fibre now is very similar to wireless and cable in the 1980s and 1990s. Initial markets were built out with the bigger players making acquisitions and then, over the next 15 or so years, the smaller markets were built. It was the same with cable, and we're starting to see it with fibre.

We've gone through a massive stage of consolidation, and now it's more focused on new markets and growth capital. I think we're in year seven or eight of a 30-plus year upgrade cycle. 60% of buildings with 20+ employees are still connected with copper, which must all be upgraded.

But it's going to take time and this is much more pronounced in the tier two markets where we focus. We're looking for businesses that have built out nice networks but need capital to accelerate and enable growth.

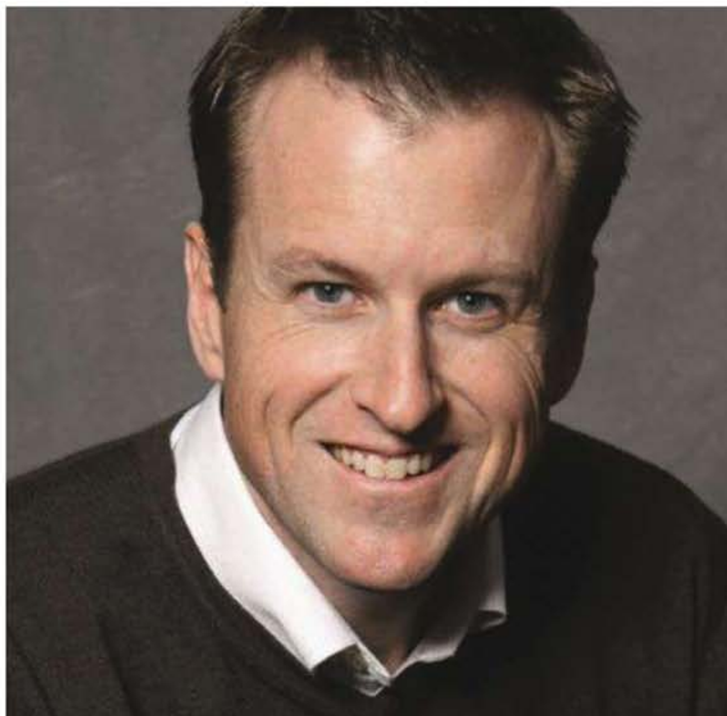
In the tier two and smaller markets where the facilities today just don't exist, although the demands of enterprises in those markets are very similar to those in tier one markets.

We have a very similar strategy in the data centre space for addressing tier two markets. Some of these smaller markets, carriers are still paying US$4 per meg for internet, whereas in bigger markets you're paying as little as US$0.75. It's really about broadening and investing in the infrastructure in the smaller markets to really address an untapped demand today.

LT: How does the fibre investment space compare with other forms of communications infrastructure?

GC: What's interesting is that, unlike technology where within six months, the next shiny company emerges by resolving a certain issue or problem, infrastructure and services are long-term trends.

It's a big misconception that the big guys like Verizon, AT&T, Level 3 and Zayo have access to a significant amount of capital and can basically dominate the space. I think scale is definitely important, but it's scale at the local level because it's really all about local relationships, local right of way, and how dense your local network is. You're competing against the dominant player in the region, you're not worried about the big national guys. Lightower's a prime example of that. Verizon was a huge customer of Lightower because this made far more sense for them than to build the network themselves.



Gillis Cashman said he sees the greatest opportunities in the tier two and smaller markets

LT: Are you still able to find assets at decent prices?

GC: It's been a very tough deal environment and for a generalist investor, it's pretty tough to find assets. What we do well is focus on under-managed assets.

We feel comfortable taking execution risks, but not technology or primary demand risks. We'll go into under-managed assets with a team to execute on the plan.

A deal we've got under exclusivity now is owned by a non-profit – they're undercapitalised and need to bolster the team. Our latest fund is buying businesses at substantial discounts to the market, but we are taking execution risk.

We leverage our relationships to recruit teams and develop the value creation strategy. As industry specialists, it is not our job to go to auctions and pay the highest price for the best asset and the best team.

Our job is to find the undermanaged and undercapitalised assets, leverage our industry knowledge and resources and drive value through superior execution.

LT: Do you see continued fibre consolidation?

GC: There's always going to be consolidation. Take cable, which is extremely consolidated, and you still see it happening there. In fibre, we've gone through the initial wave, but there are still hundreds of companies out there.

It really comes down to specific regions. There are some where you have a really nice backbone network but no laterals coming off it, for example. I think the tier one markets have definitely consolidated, so there's limited action. In tier two, some assets could benefit from additional capital to scale.

As we saw in wireless, we'll probably see another wave of consolidation. We've already seen a little in fibre. We've seen Fibertech acquired, Crown Castle buying Sunesys …

LT: What is your time window for investments?

GC: We target five to seven years because it's about building companies. There have been assets we've held for 12 years, and others like ICG that we held for 18 months.

LT: What other developments do you see in fibre?

GC: There's convergence in broadband infrastructure: towers, fibre and data centres. Zayo bought Latisys to add to their huge data centre portfolio and Crown Castle bought [fibreco] Sunesys, for example. There haven't been any huge acquisitions, but I wouldn't be surprised to see cable companies acquiring fibre assets.

LT: Are there also opportunities in international fibre?

GC: It's definitely a lot further ahead in the US. There's a bit in the UK, where Zayo's done some consolidation. The US really took off when the wireless carriers deployed their 4G networks, so the focus on infrastructure will increase dramatically.

LT: Can you tell us a bit more about your newest deals?

GC: I can't reveal details, but here's an overview. The first recently closed deal is a tier-two data centre play that's constructing tier three-grade facilities.

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The interesting thing is they'll go into a market and find the two or three largest employers with 10-year anchor tenant contracts, buy the land, build the building, and own the fibre connecting the anchor tenant to the data centre – so it's very attractive. The thesis is that as more applications move to the cloud, app performance becomes critical and therefore proximity is critical, especially for this company, which focuses on healthcare.

A misconception is that Amazon and Google are commoditising space so there'll be no need for colocation. For certain apps, that's true, but many apps are not optimised to reside in an Amazon cloud, where their proximity to a data centre is crucial. So that's been very successful so far.

We also have a company called Denovo that does consulting, managed services and ERP cloud hosting. The thesis there is that as more of the apps and those that integrate with them move to the cloud, it's becoming increasingly complex for a single enterprise to manage. It makes a lot more sense to have a trusted adviser that not only implements those systems but also hosts and manages them. We brought in a CEO, and the company's been doing very well.

Of the two we are close to announcing, one's a complex hosting business where we'll bring in a team, and the other is a fibre asset in a tier two market that needs capital to increase scale and invest in its network.

We'll look for consolidation when it makes sense. Until then, we'll aggressively invest in growth. We don't overleverage our businesses – a lot of our companies don't have debt on them from day one because we want maximum flexibility for them to invest in excess free cash flow and drive top line growth.