Ridgewood Infrastructure

Essential infrastructure investing in the U.S. lower middle market

Chase McWhorter, Institutional Real Estate, Inc.'s managing director, *Institutional Investing in Infrastructure,* recently spoke with **Ross Posner,** managing partner of Ridgewood Infrastructure, about investing in the lower middle market of the infrastructure sector. Following is an excerpt of that conversation.

How have you seen the infrastructure market evolve in terms of fund and deal sizes?

The infrastructure market is in the midst of a transformational maturation process. Institutional investors are increasingly focused on incorporating infrastructure into their portfolios, and capital inflows into the sector have increased materially. Compared with only a few years ago, managers have doubled and tripled their fund sizes to $5 billion, $10 billion and even $20 billion. These funds are investing in larger deals, for which competition has increased and the market is efficient.

How do you define Ridgewood Infrastructure's niche within the infrastructure market?

We focus on investing in essential infrastructure in the U.S. lower middle market. From a size perspective, the center of our target is $50 million to $150 million of equity per investment, with enterprise values typically $500 million or less. The U.S. lower middle-market investment universe is large, dynamic and highly fragmented, which frames the compelling backdrop against which we are executing.

What makes opportunities in the lower middle market relatively compelling?

Building on my prior comments, there are several structural elements that make investing in the lower middle market compelling, on both an absolute and relative basis.

First: Valuations. With ample opportunity and relatively less capital availability, we avoid competitive, investment bank–led auctions and create investments in essential infrastructure at attractive valuations on a direct basis.

Second: Value-creation opportunities. We invest in companies with transformative growth potential and drive value in an operationally oriented, controllable and repeatable manner. Given the scale and positioning of our portfolio companies, our operational improvements make an outsized impact and drive material value.

Finally: Exit dynamics. As we harvest our investments, we expect to benefit from a healthy exit market in which both strategic and financial buyers are seeking core infrastructure attributes in businesses like those in our portfolio. After our period of ownership, our companies are well matched to the desired investment profile of a broad buyer universe.

Can you expand on how Ridgewood is creating opportunities to invest in essential infrastructure in the lower middle market?

All of our origination efforts are underpinned by an experienced and informed point of view about market fundamentals and *where the puck is going.* With that starting point, we make targeted outreach to directly originate and bilaterally negotiate investment opportunities. We are not participating in proscribed auction processes. Instead, we source opportunities through long-term relationships and deep roots in the marketplace. There are many benefits of getting to know and working with cities, industry-leading companies, and management teams over time. In addition to our approach being constructive regarding entry valuation, it also creates more time for diligence, risk identification and mitigation, as well as value-creation planning.

What does your value-creation strategy involve, specifically?

Our value-creation strategy is focused on repeatably and controllably scaling, stabilizing and professionalizing investments. For example, our Undine portfolio company is focused on building a regionally concentrated, mid-size, regulated water utility through the consolidation of independently owned, regulated water and wastewater utility systems. The industry is highly fragmented. There are more than 65,000 utilities, and more than 90 percent of them operate at a level our larger competitors see as "subscale." During the past few years, Undine has acquired more than a dozen of these utilities typically serving fewer than 3,000 customers each. By growing the business, we drive operational efficiencies and economies of scale. Professionalizing the business involves stewardship to improve management and operations, as well as standardizing capital equipment to increase service levels in a cost-efficient and sustainable manner.

Another example is our buyout of the SiEnergy regulated natural-gas utility, which is our fund's investment in a high-growth, regulated utility providing essential natural-gas services to customers in the Houston, Dallas and Austin metropolitan areas in Texas. Under Ridgewood's leadership, SiEnergy has organically grown its customer base by approximately 25 percent to more than 30,000 connections. As we scale and professionalize the company, our areas of focus have included enhancing business-development processes, augmenting the team and implementing new management systems.

Taken together, we have positioned both the Undine and SiEnergy regulated utility businesses for eventual acquisition by strategic and core-infrastructure buyers seeking to own scale-level, well-operated, regulated utilities generating stable cash flow with strong margins.

What do you need to be successful in the lower middle market?

Success does not come from any one ingredient. In our case, it's a combination of important elements building on our differentiated relationships, domain expertise and solutions orientation. We have partnered with companies, cities, municipalities and management teams to complete P3s, buyouts, project financings and corporate JVs. When working with these stakeholders, we contribute our industry knowledge, as well as transactional and value-creation sophistication. In so doing, we always think about how to realize beneficial outcomes that prioritize the communities in which we are operating.

For example, we worked with the City of San Antonio and its municipal water authority to construct, own and operate the 142-mile Vista Ridge water pipeline, which supplies approximately 20 percent of San Antonio's fresh water, under a 30-year take-or-pay contract. The Vista Ridge project is an essential component of the city's infrastructure. It diversifies San Antonio's water supply and will provide meaningful relief to the local ecology. Ridgewood sourced Vista Ridge through its longstanding relationships in the water sector, worked with a broad stakeholder group, and leveraged our expertise to ensure the project was delivered on time and on budget. We led and completed a process to select the long-term operator of the water pipeline and recently completed a large private placement to replace the project's construction facility with long-term financing. Vista Ridge is very well positioned for continued, strong operations and, eventually, we expect a long-horizon owner will have interest in owning the asset.

You're coming off of a very successful fundraise; why are limited partners interested in supporting managers in the U.S. lower middle market?

LPs are attracted to our investment strategy because of our differentiated portfolio exposures, return profile and GP-LP alignment. Given our size, focus and relationships, we're able to access differentiated deal flow, such as regulated utilities, the largest water P3 in U.S. history, and long-term contracted high-quality essential infrastructure assets. We are able to create value at each stage of the investment cycle — buying well and implementing transformative enhancements in our businesses, with a view toward ultimately harvesting investments to a large and competitive part of the market. Additionally, given our fund size, LPs recognize there is fundamental alignment of economics within our partnership with them.

How do you focus on ESG in lower middle-market infrastructure investments?

ESG and responsible investing capabilities are a major part of who we are and what we stand for. We aim to *do well by doing good* and make a positive impact on the communities in which we invest. In many instances, the lower middle-market infrastructure companies in which we invest start off with a strong culture of employee health and safety, as well as some informal processes related to ESG. This was the case with Carolina Marine Terminal (CMT), which was our first investment through Ridgewood's Transportation Infrastructure Partners joint venture with Savage — the largest privately owned transportation and logistics company in America. CMT is a multi-modal marine bulk port that provides essential contracted transport, logistics management, and product-handling services.

Under our leadership, CMT has formalized important ESG-focused policies, procedures and practices that ensure it is operating in a best-in-class manner. In all of our investments, we focus on creating efficiencies that reduce costs, improve service levels and drive greater profitability. At CMT, energy-efficiency auditing led to the replacement of equipment that will drive energy and other savings over time. Over the longer term, we expect our ESG efforts at CMT and other portfolio companies will make our investments more attractive as investors and other stakeholders increasingly focus on the benefits of sustainable investing.

CONTRIBUTOR

Ross Posner
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Ross Posner is managing partner of Ridgewood Infrastructure and has more than 25 years of experience in infrastructure, private equity and other real asset investing. Prior to Ridgewood, Posner was a senior executive at Allstate Investments, where he established, as global group head, its Infrastructure and Real Assets business. Posner's responsibilities included creating and leading Allstate's direct infrastructure and real asset private equity investing business and also running its Project Finance and Private Placement credit portfolios. In aggregate, these businesses represented more than $10 billion of capital.

CORPORATE OVERVIEW

Ridgewood Infrastructure invests in essential infrastructure in the U.S. lower middle market. It is part of the affiliated Ridgewood Companies, a leading real asset investment manager with $6 billion in total capital and commitments.

Ridgewood Infrastructure is investing its inaugural fund, which was oversubscribed and closed at its $600 million hard cap. With a focus on the U.S. lower middle market, Ridgewood Infrastructure directly originates investments that provide essential services to customers, and it implements responsible and operationally focused initiatives to enhance value. Through this strategy, Ridgewood focuses on creating beneficial outcomes for stakeholders with investments that generate long-term, high-quality, non-correlated cash flows.

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