KEYNOTE INTERVIEW

Standing out against the crowd

Investing fundamentals in the lower mid-market offer attractive dynamics on entry, through value creation and at exit, says Ridgewood Infrastructure managing partner Ross Posner

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The lower mid-market has the most compelling competitive dynamics in the infrastructure asset class, offering the ability to negotiate bilateral transactions at attractive entry valuations before eventually harvesting investments into the larger and more competitive part of the market.

In addition, the current market environment is creating even more dealflow at the smaller end, as many of these companies seek partnerships with essential infrastructure investors to help maintain their growth and navigate through a volatile macro backdrop. Ridgewood managing partner, Ross Posner, sat down with *Infrastructure Investor* to discuss the various factors shaping growth in the lower mid-market.

Q Can you discuss the relative merits of origination in the lower mid-market, especially when compared with the larger deals space?

Ridgewood Infrastructure invests in essential infrastructure in the US lower mid-market. We see durable structural origination advantages at the smaller end of the market, where we can create attractive, differentiated investment opportunities at compelling entry valuations.

We are investing in an opportunity rich part of the market that is relatively underserved. Approximately 40 percent of transactions in our target geography require $150 million of equity or less. Critically, as readers of this publication will know, in recent years infrastructure fund sizes have grown dramatically with only 10 percent of capital now focused on our size segment. Many funds that used to invest in the lower mid-market have moved significantly upmarket, now raising funds with $5 billion, $10 billion and even $15 billion-plus targets. In recent years, some of these funds have raised their hard-caps by more than the total target size of our fund.

Consistent with what we have observed in corporate private equity, some of these large-cap and mega-fund managers are creating new strategies to focus on smaller scale opportunities. Ridgewood is solely focused on the lower mid-market. Our most senior and experienced partners lead each investment, complemented by the resources of a purpose-built team with the right relationships and capabilities to execute in this part of the market. The companies and management teams with which we partner see the value in working with us, and they appreciate the unique specialisation, focus and resources we bring to their businesses.

Whereas larger transactions are run through highly efficient investment bank led processes at the smaller end of the market it is possible to source investment opportunities directly with counterparties, potential partners and other influential stakeholders. We often acquire businesses from and partner with families or founders looking to take their companies to the next level. We can access compelling investments on a bilateral basis, thereby creating differentiated exposure for our investors.

Examples within our portfolio include the fastest growing regulated utility in the US, which we acquired in partnership with the company's management team. We created our investment in the largest water public private partnership in the US through a relationship with the company that was hired to build it, and we formed an exclusive joint venture with the largest privately owned transport and logistics company in the US through a longstanding relationship with one of its senior advisers. None of these were bought through investment bank auctions.

In addition to exemplifying our ability to source investments on a direct and bilateral basis [outside of competitive auctions], these examples also serve to illustrate Ridgewood's ability to access truly essential infrastructure companies that provide critical services to their communities and other customers. Just because it's smaller, doesn't mean it's not essential.

Furthermore, we are usually able to invest at a discount to other market precedent transactions. Although we don't always model this arbitrage at exit, we always work – and expect – to achieve it.

Another advantage that I would point to when it comes to origination involves timing. Because we are typically executing deals on a bilateral basis, we generally get a longer look when it comes to due diligence. We are able to thoroughly evaluate the company and develop more through risk mitigation and post-closing value creation plans. All in all, I would say that makes for a highly compelling proposition when compared to the larger deal market where transaction and due diligence timelines are much shorter.

Whilst all of these advantages persist throughout cycles, there is also nuance in the current environment worth mentioning. The smaller companies that

Q Where are you seeing opportunities emerge in the water sector and how do you see those evolving?

We are a leading investor in water infrastructure in the US. As I mentioned, we own the largest water PPP in the country. We also recently commenced construction on the third largest water PPP in the US: a new water treatment facility for the city of Fort Lauderdale in Florida. Added to that, we own regulated water and wastewater utilities and recently closed on an investment focused on commercial and industrial wastewater treatment. We also own a platform focused on long-term ownership of smart water metering infrastructure.

Capital needs in this sector are only going to increase as water scarcity becomes more challenging. This clearly represents a compelling area of the market and one where we continue to see opportunities across water transmission, treatment and distribution. These opportunities are typically smaller in nature and so our capital, as well as our expertise, are well placed to meet these needs going forward.

we focus on provide essential services and have non-correlated cashflows, but they are typically in the growth phase of their corporate life cycle.

They are typically financed with local or regional debt and as the debt capital markets have tightened, the owners of those companies are proactively looking for partners who, among other things, can bring a more sophisticated approach and broader relationship network to enhance their balance sheet. This has become increasingly important to prospective owners and management teams that we partner with as interest rates have risen and liquidity has reduced over the past year and a half.

Q What value creation opportunities does lower mid-market investment present?

We are executing a repeatable and controllable, operationally oriented value-add strategy. The companies in which we invest in are market leaders and provide essential services, typically relatively undermanaged. That's an opportunity for us to help enhance their business models and better serve their customers. We help take these businesses to the next level by driving growth organically and, when appropriate, via acquisition-related growth.

The lower mid-market is also well positioned when it comes to exit. As the industry has grown and matured, the market in which we exit has become both broader and deeper. For example, super-core infrastructure funds, which are highly interested in many of our investments is a relatively recent phenomenon. In short, the low-er mid-market offers differentiation on entry, differentiation through the value creation phase and then a highly com-pelling exit proposition as well.

"The energy transition represents a huge and long-term secular growth trend that requires immense amounts of capital investment"

Q How would you describe LP appetite for the lower mid-market today?

LPs are leaning in. Appetite is strong and growing. As investors in the asset class become increasingly differentiating, they are recognising the benefits of specialisation and that includes by size – in our case, the lower mid-market.

Q What challenges does lower mid-market investment present and what would you say is required to be successful in this part of the market today?

There are challenges in all parts of the market. Of course, the challenges we face may be different than those that exist in multi-billion-dollar transactions. In general, it's my view that you need to have clarity of mission, the right and experienced human capital capabilities, as well as a great culture and tool kit to work through the challenges in your chosen space.

Q How do you view opportunities developing in the energy transition?

The energy transition represents a huge and long-term secular growth trend that requires immense amounts of capital investment. We choose to focus on areas and investment structures within that where we are able to avoid the most significant capital inflows. A great example of that would be the investment we have made in Ecosave, which is a company that provides energy efficiency assets and services to the commercial and industrial marketplace. Another great example would be our Environmental Infrastructure Partners investment, which is focused on smart cities, where we work with municipalities, universities, schools and hospitals to help meet their energy transition objectives.

Q To what extent has the IRA provided a boost for the lower mid-market?

The IRA has been a fantastic federal tool to further accelerate the energy transition. From our perspective, the IRA has helped make some potential new investments more economically viable. It has helped them chin the bar of our risk adjusted return profile.

Meanwhile, for our existing investments, the IRA has helped broaden the funnel, creating a wider solution set for a larger number of customers, which is precisely what it was designed to do. In short, I would say that the IRA has been great for customers, great for industry, great for investors and great for the broader citizenry of the US. It has created a longstanding opportunity set that we view as extremely exciting. ■