Ridgewood Infrastructure

Finding alpha in the lower-middle market

Jorge Fernandez, Institutional Real Estate, Inc.'s managing director, infrastructure, recently spoke with **Ross Posner,** managing partner at **Ridgewood Infrastructure,** about the benefits of investing in the lower-middle market. Following is an excerpt of that conversation.

How has infrastructure evolved as a component of institutional investment portfolios?

Infrastructure has solidified its position as a key component of investment asset allocation, as sophisticated investors recognize its ability to deliver attractive returns along with valuable portfolio construction benefits, including noncorrelation and inflation protection. In recent years, we have also seen LPs investing in the infrastructure that enables key macro trends, such as resource conservation, digitization, energy transition and supply chain optimization. Against this backdrop, as investors scale up their infrastructure exposures, we see LPs constructing purposefully diversified infrastructure portfolios that create exposure to specialized strategies focused on specific geographies, size strata and sectors.

At Ridgewood, we invest in essential infrastructure in the U.S. lower-middle market. Our investments generate high-quality, noncorrelated cash flows with the potential to generate attractive absolute and risk-adjusted returns comprised of both cash yield and capital appreciation. The investments we make also have purposeful inflation linkage through revenue escalators and cost-passthroughs.

How do you define the lower-middle market? What makes it compelling?

We invest in assets and companies with enterprise values typically less than $500 million. This part of the U.S. market is highly fragmented and relatively less competitive. Whereas around 40 percent of deal activity requires less than $200 million of equity, only around 10 percent of the capital that has been raised is sized to invest at this scale.

At the smaller end of the market, we typically come in where others can't or won't. We invest "below" where the large and megafunds are focused, and at the stage of a company's lifecycle where others, like core investors, aren't set up to execute. In many instances, we can originate on a direct and bilateral basis, with more time for due diligence, and we can enter at relatively more attractive valuations. We then implement a repeatable and controllable operationally oriented value creation strategy to enhance the positioning of our portfolio companies.

There's a saying we like: "It's easier to turn a speed boat than it is an ocean liner." At the smaller end of the market, we can enhance the trajectory of lower-middle market businesses relatively quickly by scaling and professionalizing their operations.

The management teams with which we partner appreciate the opportunity to benefit from the sophistication we bring to implementing best-practices, investing in enterprise infrastructure, and providing capital and experience focused on accelerating growth. And once we've grown the company and its cash flows, and further enhanced its capabilities and strategic positioning, it is well positioned to be acquired by a long-horizon owner whether that be a strategic or a financial buyer.

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

I think you need a specific mindset to be able to execute successfully in the lower-middle market. We're often working with founders and family owners who have invested their entire careers in a company. In these situations, we focus on building rapport and establishing alignment about what it looks like to take their business to the next level. Our team brings distinct experience, sophistication, capability and expertise. My partners and I have owned and operated businesses in the U.S. lower-middle market for decades. We have deep experience building businesses through numerous cycles and macro environments and have distilled that to a repeatable, operationally oriented toolkit that we repeatably implement to drive value for all stakeholders with whom we partner and work. We are willing, able and interested in rolling up our sleeves. And we enjoy celebrating our collective successes.

You've mentioned there's less competition in the lower-middle markets. Does that affect your ability to exit an investment? Can you give me examples?

Part of our investing strategy involves thinking about exit at our point of entry. As we come to the end of an investment or project, it has been transformed to large-scale operating essential infrastructure, which is very attractive to a wide range of investors. By design, we exit into probably the most competitive part of the market.

For example, in Q4 2024, we sold our Vista Ridge Water Pipeline investment to an open-end core infrastructure fund. We had taken the project through construction and operated it for a number of years before exiting.

Vista Ridge Water Supply Project, TX

The largest water P3 in U.S. history, Vista Ridge supplies 20 percent of San Antonio's fresh water under a 30-year take-or-pay agreement. The current owner prevailed in a sales process that saw significant interest and competition from around the world. These would-be buyers were attracted to the long-term nature of Vista Ridge's inflation-protected, noncorrelated, contracted cash flows, but their investment mandates were not consistent with entering when we did — at the outset of construction.

As I said previously, we typically enter investments below the scale of where bigger funds invest. If you have a multibillion-dollar market-cap strategic, you might be interested in some of the things we do, but where we start just may be too small and immaterial for your business. Where we end up though is another story, and a purposeful one.

Earlier this year, we closed on the sale of a regulated gas LDC, SiEnergy, to a strategic industry leader — a public company based in the Pacific Northwest. The business had tripled in size under our period of ownership. At our point of entry, it wouldn't have moved the needle for its current owner, but at our point of exit it represented a meaningful opportunity to gain market share in the highly desirable Texas market.

> *"As we come to the end of an investment or project, it has been transformed to large-scale operating essential infrastructure, which is very attractive to a wide range of investors."*

Ridgewood is known for investing in essential infrastructure, which I think most people think of as water and energy. But you have recently invested in a cold storage company. Are you looking at other essential niche investments?

We invest predominantly, but not exclusively, across four different areas — water, transport, energy and utilities. With each investment opportunity, we consider essentiality first, as it is the foundational element of the downside protection we require. We ask: How strong are the company's defensive characteristics? Is it providing a truly critical service to high-quality incumbent customers? How replicable is the business? Is it scalable and how? Our recent investment in Valley Cold Storage was no different.

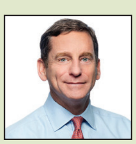
Valley Cold Storage, New Mexico

Valley Cold provides cold chain storage and logistics services that are critical to the supply chains to agriculture and food companies. It has multiple strategically located facilities, long-term customer relationships, and high barriers to entry. During our period of ownership, we will be working to grow Valley Cold both organically and through acquisitions in the highly fragmented cold storage sector. In the case of Valley Cold and our other transport and logistics businesses, we look for a lack of correlation to the broader economy, which contributes to our confidence that the cash flows will be resilient and robust.

Your approach must be working because I understand that you're coming off a successful fundraise. Is it difficult to convince investors that the lower-middle market is a good investment?

Investors understand and are increasingly interested in lower-middle market infrastructure. We recently closed our fund with $1.2 billion of commitments — materially above our $1 billion target. Our capital partners include LPs from around the world, and with many different profiles — public and private pensions, insurance companies, asset managers, foundations, endowments and family offices. We're creating value and alpha with an experienced team with a repeatable and controllable investment strategy that targets what we — and they — think is a compelling risk-adjusted return proposition with exposure to a seam in the market that we find incredibly attractive in the U.S. lower-middle market.

CONTRIBUTOR



Ross Posner
Managing Partner
Ridgewood Infrastructure

CORPORATE OVERVIEW

Ridgewood Infrastructure invests in essential infrastructure in the U.S. lower-middle market. We originate investments that provide essential services to customers and employ 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, noncorrelated cash flows.

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