



## INFRASTRUCTURE INVESTOR

# Deal flow will never run dry

## A New York investment firm is busy educating investors on the opportunity in water. Alexandra Atiya meets its co-founders to find out more

Alexandra Atiya

The need for investment in water systems both in the US and globally is enormous.

Ageing infrastructure, growing populations and the threat of climate change strain existing water resources and create demand for developing new systems and upgrading old ones. A Stockholm Institute report argues that the water shortfall for the southwestern US over the next century could be as severe as 2,250 million acre feet, depending on the effects of climate change, which would translate to as much as \$5 trillion in expenditure.

Water Asset Management (WAM) is a New York-based firm that has made it its mission to invest in water resources and companies worldwide, while having a particular focus on the western and southwestern US. In so doing, WAM has taken something of an unusual approach to infrastructure investing.

The firm's co-founders, Matthew Diserio and Disque Deane, are convinced that the water sector presents a potential windfall for private investors. They are focused on making private equity investments in US water resources, particularly in areas that might face scarcity in the future, as well as taking both long and short positions in public water equities globally.

"We think that there are some unique characteristics of investing in regulated water utilities that are superior in many ways to toll roads or bridges or even power generation or transmission," Diserio says. He argues that the "inelasticity of demand" for water makes the sector unique.

But persuading someone to entrust you with care of water supplies is no small ask, especially in the US, where there are high barriers to becoming a qualified water operator.

### HOW IT STARTED

Diserio and Deane have known each other since 1981, though they weren't always business associates.

Diserio's background is in managing long-short equity-focused hedge funds, while Deane in the mid-1990s started working with Vidler Water, a US company dedicated to investing in water resources in the arid southwestern states.

On Deane's advice, Diserio began investing in water-related equities. Then, around 2005, Deane approached Diserio with the idea of buying a US water company. Both men decline to specify which company they intended to buy, but say they were able to pull together just under \$1 billion to fund the acquisition, which ultimately fell through after the seller increased the price.

The process of raising capital and assembling managers for the acquisition convinced Diserio and Deane they might be in a good position to make further investments in water.

"In assembling our team...and then meeting with some very substantial pools of capital, as part of that process, we became convinced that there was this substantial information advantage that even at that point we had been able to pull together," Diserio says. "That experience catalyzed our relationship into launching the fund."

Deane says that the deal, even though it was not ultimately successful, showed that investors were beginning to see water as a viable opportunity.

"It was obvious that the sector itself was starting to gain institutional recognition. That was back in 2005 when we were still having to explain to some people how we make money in water utilities," Deane says.

Since then, Deane adds, there has been an increase both in entities that consider themselves water investors and in the “amount of capital that is available for investment in water opportunities”.

In 2005, Deane and Diserio officially launched their current vehicle, a hedge fund strategy with a private equity allocation.

## **HOW IT WORKS**

WAM currently has \$400 million in assets under management with \$100 million committed to private equity investments.

One example is SouthWest Water, which was listed on the NASDAQ exchange. The company “had a series of missteps,” according to Diserio.

Accounting errors led the company to restate its 2006 to 2008 income, decreasing net income in the period by \$10.2 million, according to a statement on the company’s website. NASDAQ threatened to de-list the company for delayed filing of quarterly and annual reports. The share price also suffered, dropping from around \$10 per share in late 2008 to about \$5 in the middle of 2009.

WAM, with JP Morgan Asset Management as a 90 percent equity partner, agreed to acquire the company in March last year. SouthWest was acquired at \$11 in cash per share, or about \$275 million total. Including debt, the deal was valued at \$475 million.

SouthWest was attractive for a number of reasons, according to Deane and Diserio, not least of which was its geographical reach.

The company has a presence in nine US states, with much of its operations in Texas, Alabama and California—three states that Deane says are “all water -challenged”. Deane says the company has the ability “to grow the franchise” in those and other states, giving WAM broader access to what is, ultimately, a local industry.

“It is a known entity in a number of geographical areas which gives it the ability to access and understand potential deal flow quicker than we might otherwise be able to do so sitting here in New York,” Deane says. “And the reason why it is able to do that is because its qualified operators and engineers are known in the communities where they do work.”

Deane and Diserio say they are focused on making private equity investments in the US because there is a large need for capital to upgrade water infrastructure, and because of a clear regulatory framework and rule of law.

Mark Weisdorf, chief executive officer of JP Morgan Asset Management’s Infrastructure Investments Group, says the US water sector could be an area of increasing interest to private investors. He argues that the US has a disproportionately large number of water operators, creating opportunities to consolidate services and scale-up systems in order to fund capital expenditures.

“We do believe that there are too many municipal water systems and that a lot of them are run inefficiently and don’t have access to the capital that you need to continue to maintain and grow their systems,” he says.

Following the SouthWest Water acquisition, WAM has seen an increase in the number of water operators considering the possibility of a take-private, according to Deane and Diserio.

Weisdorf agrees with WAM’s assessment. He says that completion of transactions such as SouthWest Water “piques people’s interest”.

Other examples of WAM’s investments include the privatisation of wastewater credits in Prescott Valley, Arizona, and a joint venture with the farm division of US company R.D. Offutt to acquire a Nevada farm to be used both for agriculture and water resources.

Through the hedge fund, WAM takes both long and short positions on water public equities globally.

“Some people say, ‘well, if there is great macro, a supply/demand imbalance, and a positive story around water, why would you short?’” Diserio says.

He argues that water is unique in how “segmented” it is, both in terms of geography and operators, which creates high dispersion in annual returns on publicly traded water companies.

## **IS WATER ‘INVEST-ABLE’?**

Diserio and Deane are adamant that the need for water in the US is huge. But this need doesn't always translate into opportunities for private investment.

Deane and Diserio say they have a duty to educate both investors and communities in which they operate about the potential benefits of privatisation. Still, water hasn't always been the easiest case to make to investors. Diserio says the need to "bucketize" investments often makes water a difficult sell, as it doesn't easily fit into a mould.

"When we started, what we had to explain to people about water was so incredibly basic," Diserio says, adding that many investors have since "come up the learning curve substantially".

"We are still in the early, formative days of the institutionalisation of water as an investable asset class," he says. "That's part of our opportunity. Part of our challenge and our opportunity."