

ALL THE CAPITAL, EPISODE 1

Transcript

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Keshav: Welcome to the inaugural episode of *All the Capital*. I'm Keshav Rajagopalan. I've been at PGIM for 13 years, and today, I am the Head of the Strategic Capital Group, where I work at the intersection of insurance and asset management and lead many of our strategic partnership efforts. I'm super excited about the opportunity to bring you *All the Capital*. As you may know, over the last year or so, PGIM has been working towards integrating our investment capabilities across the house. I'm excited because I see this series as a manifestation of just that, bringing together perspectives from across PGIM and showcasing the increasingly collaborative way we approach opportunities and serve clients. So thank you so much for tuning in. Now let's get started. Infrastructure needs are growing around the world, increasing demand for capital at the same time that government budgets are under pressure and banks are constrained by more limitations. Private capital is stepping in to fill the gap. Meanwhile, on the macro side, we are surrounded by a world of more persistent and higher inflation. Investors are increasingly turning to infrastructure which can provide a hedge against inflation and protections from economic uncertainty, given the essential nature of the asset class. Against this backdrop, investors capture a differentiated set of opportunities by looking through a global lens. In Europe, PGIM has leveraged its regional network to bring investors access to distinctive deals in the marketplace. The ability to provide long-term financing backed by hard assets can make infrastructure deals a compelling proposition that not only offers diverse portfolio exposures but also a public and necessary good. However, infrastructure capital structures can be highly complex, spanning multiple public and private stakeholders across multiple jurisdictions. This requires infrastructure know-how coupled with local market on-the-ground expertise. Joining me today are Josh Shipley, Managing Director and Head of Europe for Private Credit; and Federico Chiaramonte, Executive Director on the Infrastructure Team for our Private Credit platform. Thank you for joining me today. Let's dive in. To begin, I want us to spend some time understanding where we are. The opportunity set in the infrastructure sector continues to expand. What are the areas driving this growth? Maybe Josh, starting with you.

Josh: I'm really excited to cover this topic. Infrastructure is one of the most compelling areas of private credit right now, particularly in Europe where I spend a lot of my time. You know, the investment need continues to expand; and there's just several forces driving the growth. So, talking about those forces, first, there's a fundamental and ongoing need for investment in critical assets. Governments have to replace aging infrastructure; modernize their existing networks; build entirely new systems to support economic growth, electrification, emerging technologies. You have the pandemic, which really accelerated years of change into a small period, how we work, how we consume, how we communicate, how we travel, how we move goods, right. All of this changed drastically, creating new demand for new infrastructure solutions. You have the energy transition and energy security as major investment drivers. Europe, in particular, has experienced firsthand how geopolitical events and supply chain disruptions really expose vulnerabilities that these economies and countries can have and how much investment the energy systems need. You can't speak about infrastructure growth without digital infrastructure emerging as one of the largest investment themes in the coming decade. You've got cloud computing, AI, data centers, fiber networks. Just digital connectivity, right, is driving tremendous growth and investment

opportunities. And I think maybe most importantly and finally is really the expansion of the infrastructure definition. It used to be focused on your core monopolistic, very stable cash flows under concession type businesses, but today investors and sponsors are looking beyond traditional sectors, involve transportation and broader than utilities and for adjacent businesses that provide essential services. So, if you take all that supply, it attracts a wider range of sponsors, wider range of capital, wider range of asset managers, institutional investors. It's just a larger and more diverse opportunity set. And that's where private capital steps in. There's a significant funding gap. Governments and banks alone won't be able to meet that need, and I think institutional investors and private capital will be a big part of that.

Keshav: Federico, talk to us about how the investor thinks about it. What makes it such a compelling sector, and why are we hearing many of our investors looking to add exposure to the asset class?

Federico Chiaramonte, Executive Director, Infrastructure, Private Credit: Infrastructure is a very natural fit for private credit because of the characteristics of the assets that align very well with the nature of the capital. These are generally long-lived assets that can produce stable and predictable cash flows over extended periods of time. Private credit investors, including insurance and pension capital, often value that duration and cash flow visibility because those characteristics align very well with their long-term investment objectives. And that combination is quite unique. Infrastructure assets often provide essential services, benefiting from relatively inelastic demand and having meaningful barrier to entry. They are also among the few assets whose success is measured partially by how little we think about them. Nobody spends much time celebrating that electricity, water, transportation, or the internet work today; but we notice very quickly when it doesn't. Their revenue is frequently backed by long-term contracts, concession, availability pyramid, or regulatory frameworks that defend that revenue stream. And, for us as lender, that provides great visibility into the cash flows available to service our debt, including through periods of economic weaknesses. These are generally not revenues that simply evaporate during an economic downturn. Finally, many infrastructure assets benefit from inflation-linked revenues, which can provide an additional layer of resilience. So, during inflation times, if the assets revenues increase while our contractual debt remains predictable, that can help preserve or potentially improve the service coverage matrix.

Keshav: Let's pivot a little now to evaluate how you all think about, from an investment perspective, how to actually put money to work here. So, Federico, given some of these tailwinds you've described, how are investors expressing conviction in the space; and what are the types of strategies they're considering?

Federico: Building on the natural alignment between infrastructure assets and long-term capital, investors are these days expressing conviction in two ways. They're increasing their allocation to the sector, and they're also becoming more sophisticated about where they invest within it, historically, infrastructure that was concentrated in senior investment-grade financing of mature core assets. But building on Josh's earlier point, as the definition of infrastructure expands beyond traditional sector to incorporate new asset type, the range of strategies available to allocators is expanding as well. We invest across the infrastructure spectrum, from the core, core-plus, value-add assets with opportunities spanning from long-term financing and shorter duration. These allow us to offer allocators a broader menu of investment-grade and high-yielding credit strategies. To illustrate the point, we're seeing selected debt interest transaction, obviously in more infra-adjacent sectors where returns can approach what investors might target in core

infrastructure equity. While debt and equity are not directly comparable investments, this demonstrates how much the range of options available to allocators has expanded. For an asset manager, there are also different ways to seek that additional return without moving into core-plus or value-add asset. An investor can remain exposed to a mature core asset but move further down the capital structure through junior or whole core debt. In that case, that additional return is given primarily by structural subordination rather than by greater risk in the underlying asset. So, to summarize, for allocators, infrastructure debt is no longer a single allocation; and it now offers a broader range of ways to construct exposure based on portfolio duration, return, and risk objectives.

Keshav: As you point out, obviously a lot of ways to play it, which makes it both complicated and interesting. Josh, I'll come to you on the geography point. As you and I have had conversations over the years, you straddle both sides of the pond. You're an American that spends a lot of time in Europe. Talking about the European market but then maybe contrast that with the U.S. market, what makes Europe compelling, some relative value opportunities there, and then how are you and the team thinking about the U.S., though, still?

Josh: So let's start with key distinction between Europe and the U.S. is the market structure. The U.S., it's largely one market. It's homogeneous. Europe is still highly fragmented. It's fragmented across countries; the basics of language, legal systems, regulatory systems, tax regimes. It's a very different market structure across Europe versus in the U.S. And, as you kind of pointed out, this fragmentation, that creates opportunity but also complexity. Investors or allocators alike, they can't simply take a pan-year approach and expect to be successful. You know, winning in Europe requires deep local relationships, an on-the-ground presence, and a strong understanding of each individual country. And that makes the sourcing advantage real. You know, many of the most attractive opportunities are generated through a local sponsor relationship, through a regional advisor, regional bank, and management team. And access often depends on being viewed as a trusted local partner rather than a broad international capital provider. When you underwrite infrastructure assets in Europe, it's a nuanced approach, while infrastructure, as Federico mentioned, benefits from many common characteristics: essential services, long asset lives, concessions, contracted cash flows. Every jurisdiction is a bit unique, the unique regulatory, political framework, legal, local market considerations. And this can materially not only impact the structure but risk and return expectations and the competitive dynamics of any individual deal. We see a lot of attractive value and opportunities in Europe because European's capital markets are still a little bit less robust. When you look at balance sheets of corporates or infrastructure issuers alike, they still tend to be predominantly bank financed. I think institutional investors can come in, again, building out what Federico said, think of unique structures. Think of HoldCo loans versus OpCo loans and really diversify across what was previously heavily bank financed. And, again, this just creates a meaningful financing gap and an opportunity set. So we are equally bullish on both the U.S. and European markets, but I think that complexity and the nuance of the European market and the absolute need for growth, whether it's in energy, electrification, defense, aging assets, I think for all those reasons, we see Europe as a really great opportunity.

Keshav: Europe, obviously both a fragmented market and still evolving; and that leads to complexity. So, Federico, talk to me a little bit about the complexity piece here, right. That's been a theme throughout our conversation thus far. But, when you evaluate an opportunity, complexity can't be not compensated for in terms of risk. So how do you assess the risk there, and how do you think about the actual compensation required for the complexity?

Federico: So, when the structure of the economy changes, the infrastructure supporting it has to adapt. And is clearly becoming more complex. That broadens the opportunity set for us as investors, but it also introduces new risks. So what distinguishes attractive complexity from uncompensated risk? To arrive to the answer, we apply two filters. The first one is, does the opportunity generally qualifies infrastructure? And that ultimately requires the judgment of investors with decades of experience in the sector. But we also use some proprietary tools, including our infrastructure scorecard, to assess assets consistently across our portfolio. Second, we unpack the complexity by asking three basic questions: Do we fully understand the underlying risk? Can we appropriately allocate and mitigate them through our financing structures? And are we being adequately compensated? If the tests I described are met, then the complexity can create attractive, research-adjusted opportunity. If not, we can and must remain selective. You will see us invest where our underwriting expertise and local knowledge provides a genuine advantage, and we'll stay out where it doesn't. This is what ultimately it makes the market exciting for us as investors. As the sector evolves, we have more opportunity to apply our experience and differentiate ourselves from other managers by developing thoughtful solution around our borrower needs while remaining disciplined about the risk-adjusted return we deliver to our investors.

Keshav: Josh, talk a little bit now. We've been in the infrastructure space for many decades now, but it is an asset class that is getting quite a bit of buzz because of the needs and the structural tailwinds you're mentioning. So capital is coming into the space. Competition is increasing. What do you view as successful on our side as a lender?

Josh: Yeah. No doubt, Keshav, that more capital is coming in across different strategies, whether it's public-private, the convergence of public-private, ABF-type strategies. When you think of things like data centers and digital infrastructure, there's aspects that are pre-construction, during construction, post-construction. So competition is absolutely increasing. But I really don't think this is a market where necessarily the lowest price or most aggressive terms will win. Sponsors will look for partners. They're not just looking for providers of capital. They want lenders who understand their business model, their investment strategy, their forecasts. And they want structures around these goals. Relationships and reputation absolutely matter. We've been doing this for a long time, and I think sponsors value counterparties that will support them through multiple transactions, right, multiple cycles, refinancing events, not just focusing solely on a single deal. Flexibility is increasingly important. Federico got into that a bit about talking about OpCo loans and HoldCo loans and different structures. Assets are different. Jurisdictions and capital structures are different. So lenders who will be successful need to be able to tailor financing packages and solutions, and not just relying on a one-size-fits-all. Local market expertise—I'll harp on that again—I think is a key differentiator. You need information symmetry or even an information edge when you're underwriting any critical infrastructure asset or infra-adjacent asset. Being local is table stakes in that. You have to know how to underwrite these deals. You need to understand the local economies, the local market. If you're thinking of something in the energy space, it's a lot easier if you're there getting your energy bill and understanding who the competitors are, how the market's shaping, how much of your energy bill is the distribution network versus the energy retailer. I mean, these are advantages that I think can make you a more sophisticated underwriter of the potential risks. And, as complexity comes in, that's only heightened. I think being local will give you a differentiator there. Scale and breadth of capital solutions will matter. That will be a competitive differentiator, a competitive edge. For those that can provide big tickets, sponsors are increasingly want to work with providers that can provide not only different types of capital but might be able to provide the entire capital need. They might

be able to provide both OpCo and HoldCo lending, fixed and floating rate and, frankly, just bespoke solutions. So scale will matter. I think the other thing I'd want to really emphasize here is, especially in Europe, Europe has always been on the forefront of financing structures and packages where banks partner with institutional investors. A private credit investor can coexist with a bank deal and play complementary roles. The banks can provide the shorter-term floating-rate capital, and that might be one part of the solution; but an institutional investor can come in and provide the long-term, fixed-rate, durable solution to that capital structure. So I do think it's more competitive. I think it will continue to be more competitive, which means those that are participating in the space will have to sharpen their pencil and find those local advantages to build on that complexity. But, ultimately, I think success comes from combining that local origination network that I've talked about, the disciplined underwriting, structuring expertise and, frankly, a long-term partnership mentality.

Keshav: Federico, talk to me a little bit about risk and all this stuff. This is not risk-free. There's a great story here. It makes a lot of logical sense. But what are the risks that you're evaluating, especially as we think about putting our investor capital to work? What is the way to think about the risk objective and how to frame the risk?

Federico: A compelling theme does not automatically result in a compelling credit, and we need to be very mindful about risks. We may have conviction in a particular infrastructure sector, but individual assets can still be affected by poor execution, excessive leverage, regulatory change, technological disruption, or an overly optimistic demand forecast. Allocators should look for a manager that can clearly explain how the broader trend translates into cash flows for the specific asset and what happens in less favorable scenarios. For higher yielding or lower credit quality investments, the analysis should go one step further. The manager should also understand the asset's alternative uses, who might be willing to acquire in a distressed scenario, and what value could realistically be monetized if the original business plan fails. The structure should then reflect the risk identified. In underwriting the deal, investors must be able to negotiate appropriate leverage and amortization, liquidity reserves, financial covenants, restrictions on additional debt and distribution. We want to be treated as partners. The objective is not simply to have remedies after a problem arises but to create protections and opportunities to intervene before the value is materially deteriorated. And, finally, from a portfolio construction perspective, allocators should look for a manager with a global reach to remain selective across markets and capable of offering diversification across sectors, geographies, and capital structures.

Keshav: Let's pivot a little now to implementation action, right. And you've hit on some of these themes, I think, Josh. But what are some of the key trends you're seeing, the key indicators in terms of deal terms, the overall sector-wide trends in terms of today and how you're forecasting where money is being put to work and what the value is for investor capital?

Josh: Sure. Well, why don't we start with the deal terms and deal structures. As, you know, we've talked about, and Federico mentioned, we're seeing really increasing complexity—creativity might be another word for it—across the capital structures as sponsors seek more flexibility and lenders, frankly, are looking for more yield and balancing that risk-return trade-off. This comes with more risk. You do see more layers of capital. Another key thing that we've continued to talk about is what's being considered infrastructure debt. While the broadening into core-plus or value-add no doubt creates attractive investment opportunities, it does require greater underwriting discipline, underlying risks that just differ significantly versus the historical core infrastructure space. Good investors will be careful with structure around this with good covenants and mint protections. But

there is inherently more risk. If you compare, say, a monopolistic utility or an airport asset, you need to understand in these core-plus or value-add where there's demand risk, where there's commodity exposure, customer concentration, technology risk, construction risk, cyclical, right? All these begin to influence what might otherwise be viewed as an infrastructure investment in the current market but has just very different fundamental underlying risks. As a result, as we've talked about relative value and you asked about relative value, it's becoming more critical. Even within these markets, you can have subcategories where you have investment grade or high yield opportunities. I think for sector trends and secular trends, we see some of the most compelling opportunities really driven by these long-term secular tailwinds. Digital infrastructure and data centers, of course there's just a massive need, particularly in Europe, where the investment still lags behind the U.S. fiber and telecommunications networks, we've been seeing a lot of transactions there. Power infrastructure and grid modernization to support the energy transition. All that said, key ports and airports remain critical assets for these European countries and economies. We continue to see opportunities to invest in their growth. We've been active in pursuing more high-yield opportunities in the infra-adjacent space. I would think of things like healthcare, transportation. So I think there's just a lot of a broadening of the opportunity set, and I think you'll continue to see that in the coming years.

Keshav: It sounds like with the broadening of the opportunity set, and certainly more demand both from investors as well as capital coming in, I think the discipline and the longevity of view here is important, something that obviously you and your team have a legacy around. Federico, fast forward now a couple of years: how does that change? We don't need to go five, but one to two years. What are you seeing in the crystal ball, the tea leaves, on what will be important then?

Federico: Over the next few years, we will continue seeing the infrastructure universe evolve. And, with evolution, I think we're also going to be seeing some winners and losers. We don't know exactly who those will be, but what I can say is who can be a successful manager? Successful manager is someone that understands trends and risks globally but can underwrite them locally because those trends will develop differently across individual markets and jurisdictions. At the same time, we'll need to remain grounded in the fundamentals that we have applied over decades of investing in infrastructure debt. As the definition continues to broaden, the ability to distinguish between truly defensive cash flow assets and business with greater operational or market exposure becomes increasingly valuable from the manager perspective. And, to borrow a concept from evolutionary theory, it is not necessarily the strongest or the smarter that succeed but the one that's able to adapt the most. And I think that applies here. As the infrastructure market evolves, successful managers will need to adapt with it, while remaining disciplined on the fundamental credit characteristics that made the asset class attractive in the first place. And, ultimately, we might be more flexible about the label; but we should not become less rigorous about the credit.

Josh: Yeah. Federico, I might pick up on the flexible about the label. I think one of the things over the next year or two, and time will tell, is, generally speaking, historical core infrastructure, these companies can handle higher leverage. You have the predictability and the consistency and the certainty of these cash flows, often inflation-linked. But, as you expand the definition, these companies inherently are subject to more market or volume risk or other exogenous factors. Yet sponsors and investors alike are more willing to potentially put additional leverage on these assets compared to the past. If you think of just a transportation sector where you have logistics companies, trucking companies, historically those were likely financed by banks and with lower leverage levels. But a lot of them have short- to medium-term contracts. They might be

transporting refrigerated product or healthcare pharmaceutical products. There still is volume risk, though. As you start to potentially lever those businesses more, I think you are exposing them more to risk. And so, to Federico's point, you cannot be less rigorous on the credit; have to be all over the structure; and you have to be compensated for that additional complexity in return. There's a way to do that, but I think over the next year or two, Keshav, you're going to see if the market has any misses or failures because of potentially overleveraging some of these credits that inherently had more built-in risk than the traditional core infrastructure of days past.

Keshav: Well, Josh, Federico, this has been a terrific conversation, especially for our inaugural episode of the podcast. My takeaways here: Infrastructure debt is no longer a single allocation. It really is a spectrum of opportunities across sectors; across geographies, as we talked about, Josh; stages of development, Federico; and really credit qualities and positions in the capital structure itself. So it's really a challenge but such an opportunity for investors as they think about gaining the exposure. But the how here, and the how here is selecting the right manager to partner with; and I think the longevity of track record and how you all think about the space is really something compelling.

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Keshav: This has been *All the Capital*, a podcast from PGIM. Thanks for joining the conversation. Until next time.

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