

# SPEAKING OF ALTERNATIVES

## S1 EP19: Let's Talk Energy Mezzanine

**Narrator:** Speaking of alternatives with Keshav Rajagopalan, managing Director, Head of Product and Strategy, and Multi-Asset Solutions at PGIM.

Energy Mezzanine financing fills an important niche between traditional credit and equity in which growing companies can acquire much needed capital without diluting their ownership interest at a critical stage in the company's development, Keshav discusses the specialized world of mezzanine energy investing with Brian Thomas, executive Managing Director of Real Assets at PGIM.

**Keshav Rajagopalan:** Welcome to Speaking of Alternatives, the podcast where we dig into the many layers of the alternatives landscape. And today we're going to be talking about the energy landscape. We're going to focus on what PGIM does in energy investing in the mezzanine space. Really excited about today's conversation with my friend and colleague, Brian Thomas.

Brian is the executive Managing Director at PGIM and head of Real Assets. Brian is a fellow Texan and a fellow Longhorn. We both share our alma mater at the University of Texas. So Brian, very excited to have you today. Thanks for joining us.

**Brian Thomas:** I appreciate the opportunity to visit with you.

**Keshav Rajagopalan:** To kick off, let's start just to find out a little bit more about you, more about your background in investing, what brought you to PGIM, what's kept you here and what's kept you interested in both real assets, but energy investing overall.

**Brian Thomas:** Like most folks on the buy side, my background started out of undergrad in banking, in corporate banking, which ran a panoply of activities that you typically go through in your early years. So we invested in lending in all sectors, general corporate real estate. I even did some sports lending. But in the latter stage of my professional career, I've had an opportunity to start working on the energy side.

I was really. Looking for something that had more of an investor mindset associated with it. Being grad school had the opportunity to work at PGIM in their nascent energy practice, pure buy side, focused on more than simply just senior capital. It was up and down the cap stack, so we had the opportunity to be relevant to companies in the space.

The most compelling part was we acted like investment bankers because we walked in with a clean sheet of paper. We spent time evaluating the acumen and the business prospects of the platform. And as opposed to trying to push a product, we really tried to spend more time with them thinking about where they wanted to take the business, what type of capital was necessary in order to achieve those objectives, and then how did we marshal that capital from our own balance sheet and through the capital provided to us by institutional investors to meet those needs.

**Keshav Rajagopalan:** Sounds like Brian, you brought it all together and where you sit today is an intersection of many experiences you've had in your career. Now, to zoom out a little bit, real assets, what has brought you broadly into that space and what is it? Just to help frame that for our listeners before we dive into the energy topic?

**Brian Thomas:** Real assets is tough to wrap your head around sometimes in the institutional market because it's a bit of a catch all. Think of it as certainly all things infrastructure related but including natural resources as well. So if you looked at our business model, what we had for many years was a loose confederacy of independent investment platforms.

We tried to pull them together on the Venn diagram to a point where we could leverage the intersection of activities underwriting.

**Keshav Rajagopalan:** So then double clicking. Now on the energy piece, the focus of the conversation is energy mezzanine. So why do we play in that space in terms of capital structure? And also, how should investors think about what this does in their portfolio?

**Brian Thomas:** Mezzanine is another term that often gets thrown around and it means different things to different people. But starting at the beginning, we are credit minded individuals, and the mezzanine is that marriage of both credit and many instances, equity upside that sits in that nether world between traditional senior capital and equity.

And we found increasingly over the years, and we've been involved in mezzanine investing for the better part of three plus decades.

**Keshav Rajagopalan:** Including the launch of the most recent vintage,

**Brian Thomas:** our most recent energy mezzanine fund as well, which is a bit of an opportunity fund focused on that form of capital. But where you really see this applicable is in those industries, in those companies that are already up running cash flowing, but they have needs that go beyond what they're able to access the senior debt.

What if you have a business model who's. Credit profile or business model profile is somewhat transcendent. In other words, over a three-to-five-year period, they expect demonstrable change in the size, scale, and credit profile of the business, such that if they were to issue common equity at that moment in time, it would be.

Perhaps dilutive, perhaps you would be at a valuation that is well below what it would otherwise be in three to five years. So that mezzanine fits that, that in-between need where the senior debt looks equity-like because you're either structurally subordinating yourself to the senior, so they see you as junior or equity-like, but your claim is not the same as theirs.

And then the equity looks at you as debt because you're not taking an ownership interest in the business. So you'll have typically a contractual coupon, cash yield, some pick. In many instances, you also have some element of equity participation through warrants or some other attendant equity-like feature that gives you a little bit of upside to compensate you for the fact that your junior claim to the senior debt.

**Keshav Rajagopalan:** What's the investor thesis? And I know you could think of this through the cycle, but is there something about today that makes the market an exciting opportunity? And what are we looking at just from an overall allocation perspective, from an energy focus area?

**Brian Thomas:** One, I think the key is the industry is maturing. We've moved past the rapid growth phase and now we're in the harvesting phase. If you want to look at the S-curve model. For a typical capital deployment in a sector, energy, mezzanine finance can unlock the door to expansion for solid, mid-sized growing companies. These types of companies could benefit from more capital to fuel their growth but may prefer not to dilute their ownership interest by issuing more stock. The companies are focused more on free cash flow and cash flow repayment and distribution, so return of capital as opposed to return on capital per se. And this product is always going to be a bit of a niche within a niche. It's not meant to be everything to all companies, but there are many companies that have very long live reserves where the full value of those reserves is not fully reflected in the present value of future cash flows.

One where we can take almost a project financing approach, layering in additional capital to help them either accelerate their growth or extend their asset base through acquisitions. And we've seen, certainly the bank market is coming back. It's still not as active as it had been historically. Much of that is due to regulatory constraints on capital deployment by banks.

That just limits the role in the sector. We're also seeing what I'll call the tourist investors who have left the marketplace. So what's left is the locals and those that really know the business well. And so our objective is not to be everything to all people. It's just to be a lot to a few select companies that have earned the right to our money and are looking for partners in the process.

And so many of these transactions are identified on a direct basis. These are with management teams and sponsor. We've known for years. It's really meant to be tailored capital for a specific need that has a three-to-five-year horizon.

**Keshav Rajagopalan:** So we like to unpack a headline, something in the news and would love to get your thoughts on it. There's a recent article from the International Energy Agency that shows record investing in energy in 2025, and I think some of the themes there are clean technology, clean energy, and we can talk about that, but also energy security. So any reactions to either of those themes as you think about where we play and where we focus, both in terms of non-oil and gas. And then also the energy security piece.

**Brian Thomas:** Yeah, I think to talk exclusively about upstream energy ignores the broader value chain, quite honestly. Let's just look at this one for example, though the capital deployment and the real needs for energy are prolific, as we're just seeing right now, I think it's amazing how you get all these intelligent people to focus on the industry for years, and we just woke up and we realize we have an energy shortage problem.

The global need is robust because we're also becoming much more interconnected as a marketplace, and so you're starting to see natural gas move around the globe. Oil certainly has always had that ability to do so, but simultaneously with that, you're seeing the electrification of everything is driving power demand.

And you're starting to see energy security becoming a dominant theme in how capital is deployed and how governments and regulatory bodies are thinking about promoting and encouraging development of energy and energy production across the globe. It used to be five years ago, really focused on conventional energy, bad renewable energy.

Good. That was the narrative that dominated how capital is deployed. Now, more of all of the above is needed today. How quickly can we get it deployed? And now as that pace is growing, there's also a growing appreciation for the lack of infrastructure that basically supports all this. I mean, the train is leaving the station for renewable and related power generation needs, but it can only go as fast as the track is laid in front of it.

So capital dictates how fast the train leaves. But the infrastructure dictates how far the train can go and where it can reach. And so I think we're starting to see an increasing focus on capital being deployed in support of the infrastructure on a simultaneous basis, because that is going to be the governor on the pace of transition.

**Keshav Rajagopalan:** And then you mentioned it, right, on more conventional forms of energy, it is a long goodbye, right? So can you share a little bit more about that and how that fits into the overall demand picture?

**Brian Thomas:** Yeah, sure. So I think the key to level set, and I'll explain it to you like you're eight years old if you already know all these things, but people need to remember that a large percentage of both a barrel of oil and an MCF natural gas is used for something other than transportation, fuel and power generation.

In fact, better than 50% of a barrel of oil is used for other things, plastics, glues, resins, synthetics, rubbers, paints, you name it. The computer that I'm using to talk to you right now, the phone that you're going to be texting your family to tell 'em you're late for dinner. All of that is made from conventional energy resources, and so we can't quit it.

What we can do is minimize our dependency on it through diversification, and that's where I think the market is starting to think about this now. We're starting to see the needs also in the renewable side accelerate for alternative forms of capital as well, because unlike maybe traditional corporate finance, whereas companies get bigger, the risk profile of those assets and the cost of lending to them drops as they get slightly bigger every year. They get slightly more profitable every year. As an energy company goes through its lifecycle, its risk profile, its need for financing, and the purpose and timeline for that financial need evolve the world of energy and energy infrastructure, particularly in the power side. Risk tends to move in step change moments. Because you're trying to get notice to proceed. You're trying to get permits; you're trying to get the project built. You're trying to get a long-term offtake power agreement signed. Each one of those events is not the small sloped linear movement. It's a step change moment, and so you're starting to see capital being formed to address a specific moment in time.

With maturity that also acknowledges at some point that risk profile drops demonstrably, and then that sponsor or that project wants to roll into a longer term and cheaper form of capital. And so institutional investors such as PGM are working to make sure that we can match the capital for each of those stages of a project financing's life, so that we could be relevant to sponsors and developers without having to transition to a different relationship.

**Keshav Rajagopalan:** It's really interesting to think about those step change moments because like you said, you're financing something with a maturity in mind, and then the risk profile of that borrower or what you're financing changes, right?

**Brian Thomas:** You don't want to solve a five-year problem with 30-year money and vice versa.

**Keshav Rajagopalan:** It's a really important construct here just to think about the actual duration that you're focused on. So we talked a lot about the opportunity here. There's clearly demand, the diversification that is occurring in terms of energy supply.

Talking about some of the headwinds, where we are seeing some challenges, either regulatory investment sentiment, when you're out there, what are you focused on and kind of trying to navigate around.

**Brian Thomas:** I think the best way to do it is to split it between conventional energy and power and renewables, because they're both relevant and particularly increasingly, the power and renewable side is going to garner the lion's share of capital deployment over time. But starting with conventional energy, oil and gas, we largely focused just on the U.S. and Canada because we think those are the best markets.

The most informed, sophisticated producers, certainly the most responsible in terms of their local, state, federal compliance and related environmental and ESG applications. But the tailwinds that support this, it's an industry that's maturing. There's greater discipline concentrated in the hands of larger public operators.

Literally, the top 10 operators in oil and gas in the United States produce 75% of the volumes, so the other 500 operators. They can pretty much drill as much as they want and do as much as they want. Basically, knowing that the supply and demand equation is protected by large public entities that are really focused on returning capital back to investors, it's focused on free cash flow, as we've mentioned before, and the need for debt capital to fully develop the reserves before these entities could sell them has increased considerably.

So the duration that the equity owner has to hold these assets has extended considerably, and so the capital needs are expanded accordingly. Those feed into the need for alternative credit capital and the tailwinds. Those are the normal ones, and we've known about them for years.

In a sector such as energy, it's inescapable and unwise to ignore political risks and opportunities. That reality can create a special role for mezzanine financing and its inherent flexibility.

China is becoming certainly less of the guaranteed demand growth component that it had been over the last 10 plus years. We have the vagaries of OPEC behavior as they roll back and look for market share, but at the end of the day, all of the producers are looking to make money off production, and so I think there's greater discipline.

There's less likelihood of a supply shock. It's really becoming more of a demand equation and how that gets managed. Ultimately, the one element that we have to always pay attention to is election cycles Globally. We're moving into a much more populous model across many countries, and so I think with respect to public policy and behavior, we just have to be very mindful of what's going on in election cycles and how that impacts government incentives or taxes or other restrictions on activity or a promotion of activity that changes every election cycle because whether it's power or oil and gas, remember.

These are long-term investments for the equity equation. So how do you deploy capital for 10 or 20 years when the strike zone of government regulation changes every election cycle? It's like changes in tax policy. It throws sand in the gears of progress in capital deployment. So that's just something that's becoming an effort.

Important equation. Now with respect to power. The headwinds, certainly, I think data centers hyperscalers, the demand equation associated with electricity is expanding considerably. How far and how fast that is. No one I think really has a good command of it, but they do know what direction it's traveling in, and that's more than enough to incentivize people to get interested in the sector.

In Europe, what we're seeing is increasingly challenged landscape for project equity is creating interest in the need for non-diluted financing solutions. So this is where all [00:15:00] credit. Mezzanine capital in some instances, plays a role because it helps accelerate the ability to get these projects built within a certain finite timeframe because the developers are trying to beat the clock on the sun setting of certain tax incentives or otherwise.

So that's a classic example of working with developers who don't want to dilute their equity returns. Recognize that by virtue of issuing mezzanine capital, they're kind of renting equity. For three to five years until these projects get up and running and then they can pay it off and basically focus on operating their projects.

**Keshav Rajagopalan:** It's solving that step change moment

**Brian Thomas:** 100%. In Europe, certainly you've got the net zero by 2050 policies that are in place that are incentivizing the development of renewable resources, and so that's accelerating the need to pardon their grid and become more diversified in terms of their energy sourcing.

**Keshav Rajagopalan:** Obviously it's a whole host of both opportunities and challenges to navigate. So we typically like to ask a few questions from the floor, what we're hearing from clients via our distribution teams. I have a couple for you. First, as you mentioned, this, investing is very local, right? You all are originating and finding good companies to lend to. How do you think about allocation at all? At the end of the day, it's fundamental, it's company by company. But do you actually think about diversification of where those companies play, how they play it? I assume you're not going and sometimes finding companies that would compete against one another. Right? So how do you think about allocation of companies in terms of across the energy sector?

**Brian Thomas:** Yeah, it's certainly a key issue in the general corporate world where you have two companies that make cars, right? They could be, and so a consumer can either buy Ford or Tesla or GM or something else. In the world of commodities, it's a little bit less of an issue because it's a global commodity.

You can have two companies that you own that sit right next to each other and what they do in terms of their production activity has no bearing whatsoever on the price of the commodity that they sell. Certainly, that's the case in oil and natural gas. A little bit different in the world of power because power isn't as global as oil and natural gas.

So you have these microclimates in terms of like the transmission grids in the markets that are made, and so. You can have two power plants next to each other and they really don't impact it. But you do have to worry about co-location of too many power plants in one region. P Jam, which is the marketplace in the East Coast, that everyone in the New York and New Jersey area buys power on is having some issues on that dynamic.

With the surge of renewable development on the grid, that has a zero marginal cost. And so what happens when everyone bids into the marketplace, they can collapse the power prices and the consumer. Generally likes that, but at the end of the day, you also have a high level of renewable power generation that's non dispatchable.

So the flip side of that is you also have weather events where that power generation isn't available either, and so you have to have a healthy balance in the end. Our goal is to vet companies and the management teams that do the best job at providing these types of resources at the lowest cost. It is a scale game, lowest cost wins.

So how we allocate capital is a more a function of that equation than whether or not two people are co-located.

**Keshav Rajagopalan:** Helpful to think about and back to your very local point in that you're identifying these companies. Maybe another question, what excites you about the energy landscape? You've been in this space now for a little bit.

You look forward five years. What is really exciting? Both energy, power, renewables, et cetera. Where the puck is going and where capital will be needed and what keeps you interested in the space?

**Brian Thomas:** Well, it is about the most dynamic industry you can be in just outside of, maybe in Silicon Valley. As we mentioned, it's dominated by entrepreneurs, but it's also dominated by companies that actually know how to deconstruct risk and take calculated risks.

And so from the investor standpoint, they're speaking my love language in that equation. I do like the fact that our platform is holistic in its view. In other words, we co-located our power and our energy groups a long time ago because what you oftentimes find is institutional investors that separate the two groups, and so they each kind of operate in their own echo chamber wishing for different things.

We like the crucible of debate that comes with investing across the entire energy value chain. And what I think we're starting to see is an appreciation in the marketplace for much greater level of symbiosis between conventional energy resources and renewables, both in terms of the power generation that's being put in place, but then the backup generation that's needed to manage the volatility associated with renewable supply.

Certainly, the data centers are exposed to that in living color. We're starting to see the expanse and touch of electrification really making its way. So we're not doing this for altruistic reasons, but when you have the opportunity to deploy capital thoughtfully and achieve an attractive risk adjusted return, and simultaneously seeing your impact on the marketplace, that's what gets me excited.

You know, we're a solution-driven company. Our investment activity is largely based on the relationships that we have with the C-suite of companies that come to us for advice. My advice is free. My money is not free, but we formed these relationships and when we can provide solutions for companies to get to where they want to go for the benefit of their stakeholders, we've done a good job.

**Keshav Rajagopalan:** Well, Brian, thanks. This has been a really interesting conversation. I covered a lot of ground. Three key takeaways for me as I was listening and just taking it all in. One is I think you hear in your voice, and it's obviously the passion, but just how dynamic this industry is, which makes capital allocation super interesting, but also a real opportunity for investors.

You think about energy, power, renewables, what all is there and how dynamic it is. But it's all really based on the demand that's there. Two is I really like your step change idea. The fact is as you think about financing solutions and you're underwriting a company, you're thinking about what that need is over a specified horizon, and that's the solution we're trying to provide. And then that's also how you underwrite the risk and think about the investor return. So this isn't some that the farm 30 years from now, what happens?

You're thinking about a specific risk and underwriting it with that step change, which is a really interesting way to think about the investment process. Three is really the thesis here, right? This is alternative credit at the end of the day, mezzanine, where we're playing in the cap structure, sitting in between equity and debt, but it is cashflow oriented, so it allows investors a really interesting alternative exposure while at the same time thinking about cashflow as the thesis, which ultimately kind of makes it look like a bond instrument, but with the upside of kind of the equity pieces that could come with it.

**Brian Thomas:** These are not off the rack solutions that you want to do that. That's what the public market is for. But these are tailored solutions for specific needs and those institutions that have specific expertise, because this isn't the sector that you want to dabble in. You want to basically rely on those people that have been living in the market for some period of time.

But your ability to come in there and literally tailor a solution for a specific need for a finite period of time, that's when you're adding real value, and that's when you can get paid for the alpha. Because when it becomes commoditized, anybody can walk in the door, look at a rating and deploy capital, and it's really hard to create value in that instance.

But when you can really come in and add specific, tailored solutions based on your knowledge of the company, the sector, the capital stack from senior debt, all the way down to structured equity and project financing, that's when you can marry the expertise with the capital and create real value for investors.

**Keshav Rajagopalan:** I think you have summed it up well, Brian really enjoyed the conversation and thanks for joining me today and taking us through energy, power, and renewables investing.

**Brian Thomas:** Always a pleasure.

**Keshav Rajagopalan:** Well, Brian, thanks so much for an enlightening conversation. Really enjoyed it. On the next episode, we'll be taking the show on the road and we'll be in London, or we'll be featuring highlights from the PGIM EMEA Investor Forum.

So join us next time on speaking of alternatives with Keshave, a podcast from PGIM. Follow, subscribe. And if you like what you hear, go ahead and give us a review and be sure to look for the podcast. The Outthinking investor is also from PGIM.

This podcast is intended solely for professional investor use. Past performance is not a guarantee of future results. All investments involve risk, including the loss of capital. PGIM is not acting as your fiduciary. The contents are for informational purposes only, are based on information available when created, and are subject to change.

It is not intended as investment, legal, or tax advice and does not consider our recipient's financial objectives. This podcast includes the views and opinions of the authors and may not reflect PGIM's views. PGIM and its related entities may make investment decisions that are inconsistent with the views expressed herein.

This podcast should not be reproduced without PGIM's prior written consent. No liability is accepted for any direct, indirect, or consequential loss that may arise from any use of the information contained in or derived from this podcast. This material is not for distribution to any recipient located in any jurisdiction where such distribution is unlawful.

PGIM is the global asset management business of Prudential Financial Incorporated, which is not affiliated in any manner with Prudential, PLC, incorporated in the United Kingdom, or with Prudential Assurance Company, a subsidiary of M&G PLC, incorporated in the United Kingdom, copyright 2025. The PGIM logo and the rock symbols are service marks of PGIM's parent and its related entities. Registered in many jurisdictions worldwide.

**For Financial Professional Use Only. Not for use with the public.**

The views expressed herein are those of PGIM investment professionals at the time the comments were made and may not be reflective of their current opinions and are subject to change without notice. Neither the information contained herein nor any opinion expressed shall be construed to constitute an offer to sell or a solicitation to buy any security.

Certain information in this commentary has been obtained from sources believed to be reliable as of the date presented; however, we cannot guarantee the accuracy of such information, assure its completeness, or warrant such information will not be changed. The information contained herein is current as of the date of issuance (or such earlier date as referenced herein) and is subject to change without notice. The manager has no obligation to update any or all such information, nor do we make any express or implied warranties or representations as to the completeness or accuracy. Any projections or forecasts presented herein are subject to change without notice. Actual data will vary and may not be reflected here. Projections and forecasts are subject to high levels of uncertainty. Accordingly, any projections or forecasts should be viewed as merely representative of a broad range of possible outcomes. Projections or forecasts are estimated, based on assumptions, subject to significant revision, and may change materially as economic and market conditions change.

This material is being provided for informational or educational purposes only and does not take into account the investment objectives or financial situation of any client or prospective clients. The information is not intended as investment advice and is not a recommendation. Clients seeking information regarding their particular investment needs should contact their financial professional.

Prudential Investment Management Services LLC is a Prudential Financial company and FINRA member firm. PGIM Investments is a registered investment advisor and investment manager to PGIM registered investment companies. All are Prudential Financial affiliates. © 2025 Prudential Financial, Inc. and its related entities. PGIM, PGIM Investments and the PGIM logo are service marks of Prudential Financial, Inc. and its related entities, registered in many jurisdictions worldwide.

5019858 Expiration: 12/31/2026