KEYNOTE INTERVIEW

An exciting combination





The opportunity for stable cash yields, attractive risk-adjusted returns and greater diversification away from corporate credit makes infrastructure debt appealing to investors, say Ares Management's Patrick Trears and Roopa Murthy

With its relative downside protection and potential to benefit from today's powerful mega-trends, infrastructure debt is becoming increasingly popular with investors.

While digital infrastructure and energy are fuelling dealflow in this segment, transportation and utilities are also providing compelling opportunities.

The opportunity set differs by geography, however, with an emphasis on M&A-driven transactions in Europe and on infrastructure buildout in the US.

And according to Ares Management partners Patrick Trears, global head of infrastructure debt, and Roopa Murthy, head of infrastructure debt for EMEA, that buildout should accelerate in the current macro environment.

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Q How would you describe the opportunity that exists in infrastructure debt today, and how has that evolved?

Patrick Trears: Starting at the 10,000-foot view, lenders today are looking to participate across the capital structure, and infrastructure debt is well positioned to provide that sort of flexibility and diversification.

From a risk perspective, since infrastructure assets are protected by high barriers to entry with revenues that are typically tied to long-term contracts, investors can generally benefit from long-term stable cashflows. The risk of default is therefore relatively low, regardless of where you sit in the capital stack.

Over the last 15 years, as the infrastructure debt space has matured, you've really seen lenders increase this emphasis on risk mitigation with a stronger focus on relative downside protection. As a result, investors can also benefit from greater covenant protections today, often beyond those typically seen on the corporate lending side.

Roopa Murthy: That raises another important evolution in the infrastructure debt space; historically banks have dominated, but now private institutional capital is increasing market share as sponsors are seeking private lenders that can provide bespoke capital

solutions.

For example, scaled lenders like Ares provide subordinated debt, unitranche and investment-grade solutions that can provide both borrowers and investors the benefit of diversification across multiple types of infrastructure credit.

Q What role can infrastructure debt play in investors' portfolios?

PT: Bringing together what we just discussed in terms of the market opportunity today, the role of infrastructure debt is really threefold.

First, it can provide stable cash yield. Second, it can generate attractive risk-adjusted returns, as the assets themselves are backed by long-term contracts. Third, it can deliver enhanced diversification from direct lending, which our team has found has very little correlation with infrastructure debt.

We think that covid, in particular, highlighted infrastructure's strengths, with a lot of assets meeting or outperforming base cases. Infrastructure is a sector that has now been tested in a downturn, and investors have increasingly come to appreciate the value and resiliency that infrastructure debt can bring to a portfolio.

Q How are the sectors you invest in changing and what opportunity do you see for growth?

PT: We believe that a diversified approach should serve as the foundation for any successful strategy, and this typically involves investing across four main sectors: energy, digital, transport and utilities. Diversification like this allows private lenders to offer investors exposure to opportunities across the infrastructure landscape and the globe.

Of course, there are some infrastructure mega-themes that are commanding a lot of attention. Digital infrastructure assets are especially in focus right now. The growth this space has experienced has been phenomenal, all backed by incredible demand and hard assets. With the advent of AI, that demand should only increase.

Transportation is interesting as well. As we move towards the electrification of the network, you are seeing opportunities around EV charging stations, for example, as well as intermodal logistics centres. Of course, private capital managers always need to remain disciplined, but being at the forefront of these asset classes also allows managers to capture opportunities right on the heels of these emerging trends.

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PATRICK TREARS

"There is significant change going on in the world today… [and] infrastructure is directly impacted"

ROOPA MURTHY

RM: There is significant change going on in the world today, and whether that change involves decarbonisation, digitalisation or increased mobility, infrastructure is directly impacted. That is creating a wealth of exciting opportunities for lenders.

Within digital infrastructure, data centres represent the fastest-growing subsector, simply because of how much data we all consume today. At the same time, there are also opportunities to provide capital solutions in the mobile towers sector.

Towers have historically been owned by mobile operators, but those mobile operators now face significant cashflow issues and have recognised that passive infrastructure is not core to what they do.

In many cases, they are spinning out that passive infrastructure to infrastructure funds, and as a result, infrastructure debt managers can step in to help fund those transactions.

Energy is also a central theme and one that is playing out differently in different geographies. In Europe, there is real momentum behind renewable energy as coal plants are being phased out. In 2024, wind and solar energy generation actually overtook

coal generation in the EU for the first time. There is a clear need for additional renewable energy production and clean energy solutions for other sectors such as transport and industrial.

In the US, by contrast, there is expected to be a strong focus on LNG, and the market expects to see plenty of opportunities to invest in this space in the coming years.

Q How do you identify the right assets to back and has the emphasis of your selection process and due diligence changed amid a new macro environment?

RM: We have a clear view regarding how we approach new investments, and we believe this philosophy has been largely consistent over our nearly 15-year history. Like any disciplined debt manager, we look for assets with long-term, stable cashflows. This often correlates to assets that are underpinned by long-term contracts, or some sort of regulatory regime, and have historically continued to perform irrespective of the macro environment.

Experienced managers typically only lend to assets that have a demonstrable track record, so we also need to be able to analyse that operational history. Finally, identifying assets with a strong foothold in the markets where they operate, either in terms of a monopolistic position or very high barriers to entry, is key.

Q How would you describe competitive dynamics in the infrastructure debt space and how are market players differentiating themselves?

PT: If you look across the infrastructure space more broadly, you will find very large infrastructure equity funds being raised, primarily by the top 10 infrastructure managers, which currently control around 80 percent of total assets under management. If you have $30 billion in equity funds being raised, you can figure that those equity funds are going to need approximately $60 billion in credit to support them. So, first and foremost, the size of the overall opportunity is significant.

Managers that can provide capital solutions to all parts of the capital stack and every key sector can differentiate themselves from the competition, which may focus on a single sector or region, or on a single part of the capital structure.

RM: Beyond this diversification, another key differentiator is scale. Infrastructure assets tend to be very large, and the quantum of capital required to support them therefore also tends to be large when compared to corporate lending.

If you can finance an asset at that scale by writing a single check for over $500 million, that is incredibly powerful and a key advantage for private lenders in this industry. ■

Q To what extent does the nature of dealflow vary by geography?

RM: The market is seeing strong opportunities across the world in each of the key sectors, but there are nuances depending on the region that ultimately underscore the importance of having global scale.

In Europe, there has been heightened M&A activity. A lot of dealflow is stemming from acquisition processes where one infrastructure manager is looking to sell an asset, and another is looking to buy. That M&A activity has been somewhat muted over the past couple of years due to the higher interest rate environment, but we are now starting to see a resurgence. Infrastructure funds must exit at some point, after all, so it is a consistent source of opportunity for lenders.

PT: By contrast, the US is in expansion mode. While energy and digital infrastructure are of course global mega-themes, we are seeing exceptionally high levels in the US.

We would expect the current US macro environment to further catalyse the buildout of digital infrastructure, given projects geared towards AI expansion are in particular focus within the new political administration. In the process, capital intended for data centres may have a spillover effect for other sectors, including the transportation and utilities required to support this huge push.

