

KEYNOTE INTERVIEW

A roadmap to decarbonisation



The investment opportunities supporting the energy transition and sustainability are evolving and provide compelling risk-adjusted returns, say Ares Management's Keith Derman and Andrew Pike

Q How do you define sustainable infrastructure and how does it relate to the energy transition?

Keith Derman: At its most basic definition, you are talking about assets, projects or systems that provide essential services to society that are also environmentally friendly. We typically think about sustainability as being something that doesn't compromise the future and can have a positive impact for society.

Sustainable infrastructure assets are driving the energy transition. And this is first and foremost a success story of cost curves. Costs first declined in

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renewables and now have come down in storage. We expect costs will soon shrink for green fuels, too. These cost declines allow for growth and increased market share and give us the roadmap to decarbonise the power sector, the transportation sector and the broader economy, including industrial operations.

Andrew Pike: The energy transition has been happening for 20 years. What makes it different today is the expansion

of this transition well beyond what we think of as just the power ecosystem and into all facets of our economy.

Our strategy has been consistently capturing that dynamic when we think about climate infrastructure investing. We have conviction over what that definition is and we welcome our investors to join us in the thesis.

KD: When we think about these investments, we are setting the bar in a way that we think is sustainable and that we are comfortable with. Others will define sustainability more rigidly or more flexibly.

Ultimately, we are investing in

climate infrastructure, energy transition and sustainability, and we are looking for good companies, good assets, good management teams and compelling risk-adjusted returns.

Q How have you seen the opportunity set in sustainable infrastructure evolve and where do you think it will go from here?

AP: In the last several years, the thesis would have been fairly confined to energy production – the production and distribution of green electrons. The focus on sustainability today extends much further again, into all facets of the economy, including sustainable agriculture, vehicle electrification and green fuel production, to name a few.

KD: We pivoted our focus and mandate a number of years ago away from natural gas generation and towards the energy transition and sustainability. Initially, that focus came with us being involved with wind and solar, as well as energy efficiency, and even storage going back five or six years.

As we developed an appreciation for the pace of change, and the prospects for innovation and how those opportunities could also provide compelling risk-adjusted returns, we began to expand our mandate and embrace a new wave of sustainable infrastructure.

This includes a range of assets that are forward-leaning but all use proven technology, such as: EV infrastructure, for commercial and public fleets; climate resiliency; resource efficiency including water; controlled agriculture; green hydrogen, which we see as offering an opportunity set at the asset or project level; and of course digital infrastructure, which we believe is so important to all of our ways of life.

Q Is natural gas part of a sustainable strategy?

KD: Natural gas has an incredible amount of positive attributes and is a critical resource in terms of reliability



Q How is the geopolitical conflict in Ukraine impacting the industry?

KD: It is just a tragic situation in so many respects. While there are still impacts we can't fully appreciate, we are definitely seeing signs of a paradigm shift in the industry as it relates to perception and prioritisation around energy security, resilience and reliability.

There have been other disruptive events like Winter Storm Uri that have triggered these kinds of awakenings, but I don't think of this scale or magnitude. We are seeing that many governments and consumers are viewing these issues through a different lens today and that is going to push investors to change how they make decisions on deployment and capital allocation.

AP: One of the underpinnings of our strategy is to deploy capital towards scaled businesses and scaled teams. When we think about the impact globally about supply chain inflationary risk on cost, nobody is immune, but we believe businesses of scale have an inherent advantage to navigate a little bit more adeptly and we are positioned to do that as well as anybody.

“We will need natural gas to support our long term decarbonisation goals while keeping our economy moving”

KEITH DERMAN

and resilience. It is absolutely our bridge fuel and is transitional and ironically we will need natural gas to support our long term decarbonisation goals while keeping our economy moving.

This is because we need natural gas to support renewables in markets where the value proposition for storage is not sufficient or in markets where renewable penetration is just at such incredible levels that storage has not kept up. It is crucial and incredibly important.

However, it is difficult to define a fossil fuel as sustainable. It is not how we at Ares define sustainable, but we recognise its applications in progressing toward a sustainable future.

Q Are you seeing more opportunities beyond assets, into platforms and companies?

AP: The fragmentation and acceleration of the energy transition over the last several years has brought to market a growing set of platform and company growth equity investment opportunities.

A central tenet of our strategy is the flexibility to invest both at the asset level and at the corporate level to help companies grow or help build assets. One example is our funds' acquisition of the majority equity interest of Apex Clean Energy, one of the largest privately owned clean energy companies in the US.

Our funds acquired the controlling interest in Apex after having executed a number of one-off project-level transactions with them, so it is a perfect case study to answer your question.

One of the rationales for moving from project to corporate was the opportunity for our fund investors to own and control Apex's 40GW pipeline. We intend to build out those projects on our balance sheet to create a sustainable operating company of significant size and impact.

KD: Your question goes back to the notion that the energy transition isn't just about utility scale renewables; it is all these other sectors of the market that are driving sustainability and decarbonisation in the broader economy. These come in a lot of different shapes and sizes, which necessitates considerable flexibility in how you invest and in what you invest.

One particularly interesting element of the energy transition is the growth of distributed generation. This is not a typical wind or utility scale

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ANDREW PIKE

solar project but rather commercial and industrial customers, which means smaller assets and it makes it hard to play those opportunities at the asset level. If you are going to do something of scale in distributed generation you need to be invested in a company and in control of its pipeline.

That opens the door to more platforms and corporate investments and not just assets. Of course, we directly constructed nearly 1.5GW of wind last year, so putting steel in the ground as a project-level sponsor remains critical to our value-add strategy.

Q What are the benefits of having a flexible capital mandate in today's market?

KD: Flexible capital is a term that people frequently use to mean the ability to pivot within the capital structure. Ares is one of the leading credit managers globally, so that approach to investing is absolutely something with which we have deep experience.

But for Ares Infrastructure Opportunities, we think about flexible capital a bit more broadly. It is essentially a three-dimensional, very dynamic investment strategy. As we just pointed

out, we have the ability to invest in assets, projects, companies and platforms, to invest anywhere in the life-cycle of those investments and to invest anywhere in the capital structure. It creates an even larger market opportunity while also giving us a lot of opportunity for downside protection, value creation and alpha generation because of our ability to pick and choose our entry point.

Q With the influx of capital chasing opportunities related to the energy transition, what should LPs look for in a manager?

AP: The energy transition, climate and sustainable investing requires a dynamic strategy that is flexible in how it invests. The industry and the opportunity set will be different in three or four years to how it is today.

A manager needs to have experienced that kind of change and needs to have the flexibility to manage the opportunity set as it evolves. That, to me, is one of the most important components of fund management.

KD: It is about experience and discipline. Experience doesn't mean just having invested through a bull market. You need somebody who has experience investing through cycles, who has seen commodity fluctuation, recession, inflation and interest rate movement and who understands how these macro events will impact markets.

Discipline is also incredibly important. I view the current market for energy transition as a little bit of a 'kid in a candy store' moment where you might want everything you see. There is so much to consider and so many companies looking for capital. Our job is to work with what we believe to be the best management teams and companies, be patient and disciplined and be able to do repeat deal flow with businesses. ■

Keith Derman and Andrew Pike are co-heads of Ares Infrastructure Opportunities



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