



Kayne's Baker: Energy Industry Is Well Set Up For The Next Five Years

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Jim Baker, managing partner and co-head of energy infrastructure at Kayne Anderson Capital Advisors. Read the Q&A below as Jim says that the energy transition – the push away from traditional fossil fuels towards renewable sources – will take decades, creating a long-term megatrend in the energy business.

With the last few years of global turmoil highlighting the critical nature of energy and the importance of keeping supply levels appropriate, energy infrastructure companies are wide-moat



businesses that should ride out any economic downturn comparatively smoothly while generating consistent income for investors.

Jim Baker

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CHUCK JAFFE: Jim Baker, managing partner at Kayne Anderson Capital Advisors is here, and we're talking energy infrastructure investing now on The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator will point you in the right direction. And today I'm joined by Jim Baker, managing partner and co-head of energy infrastructure at Kayne Anderson Capital Advisors, which some of you may know as Kayne Capital, because that's what it sometimes goes by. But if you like what you hear and you want to learn about the firm a little bit more no matter what you call it, go to KayneFunds.com. Kayne, K-A-Y-N-E, KayneFunds.com. If you're looking for more information and more direction on closed-end funds, business-development companies and interval funds, check out AICAlliance.org, the website for the Active Investment Company Alliance. Jim Baker, thanks so much for joining me on The NAVigator.

JIM BAKER: Thanks Chuck, I appreciate you having me on your show.

CHUCK JAFFE: This is a year that has been topsy-turvy, filled with a lot of anxiety, and oh by the way, it's been an eventful time not just this year, last year too when the market was so down, et cetera, for the energy sector. So let's start there, where are you right now on energy and the opportunity in front of us?

JIM BAKER: So we are bullish on the outlook for energy. As you said, there's certainly no shortage of things to be worried about in the broader economy, in the broader markets. But as we look at the backdrop over the next, call it five to 10 years, and particularly in North America, we are very excited about the energy industry.

CHUCK JAFFE: There's the energy industry and then there's energy infrastructure, and I of course laid it out in your title, you're co-head of energy infrastructure. Let's talk about what the opportunities in energy mean for infrastructure and how tied at the hip are they? Is there a reason to say, "I would rather be investing in energy infrastructure than in energy at this point"?

JIM BAKER: That's a great point. Why don't we do just a quick recap of the last few years, because I think it's a good setup to talk about where we are today and where we're going.

And so if we just wind the clock back to early 2020, so I think we all remember life before the pandemic, I think it's fair to say that that had a profound impact on all of our lives and it was really unprecedented in the energy market. We had mandatory lockdowns, first time that's ever happened, and our way of life changed overnight, and we saw instantly a rapid decline in consumption of energy unlike what we've ever seen in modern times. At the same time really over the last few years, there's been increasing discussion about a phrase called "the energy transition", which is a push to reduce carbon emissions and transition away from traditional fossil fuels into lower carbon and renewable sources. This of course is being done in an effort to minimize the impact of climate change, but this transition isn't going to happen overnight. In fact, it's going to be a multi-decade transition in our opinion, and it's really the biggest megatrend in energy. You're talking about changing an energy system that's really been developed over this last century, so it's going to take a herculean effort for that to occur. And then unfortunately just to spend a minute on the very unfortunate event which first occurred a little over a year, which is the Russian invasion of Ukraine, and really the concept of energy security. No question the invasion is a tragic event, it's got very far-reaching geopolitical implications, and you had commodity flows across the globe basically turned on their head as a result of this invasion and it really created an energy crisis in Western Europe for the majority of 2022. Things have calmed down, but I think it's fair to say that energy security is going to be a top-of-mind item for nations across the globe really for the foreseeable future. And so if you take all those things in conjunction, I think probably an obvious statement, but it should be very, very obvious that energy is critical to a functioning global economy. It's, generally speaking, something that we all tend to take for granted unless it's not readily available and affordable, and then we raise our hand and go, "What the heck's going on?" And I think what's happened over the last few years illustrates, in our opinion, how interconnected the global energy market is and how important it is to have a thoughtful, pragmatic energy transition. But at the same time, balance those goals against the desire to have energy security and energy that is affordable, that doesn't otherwise cause undue impact on inflation and things of that sort.

CHUCK JAFFE: Now let's talk about the opportunity in energy infrastructure versus energy. Some of that came out I think in that answer, but I think there's more to steer us to the infrastructure side that we need to hear.

JIM BAKER: Sure. Maybe just to level set, when we talk about energy infrastructure, so these are the logistical assets in the energy cycle, so the pipelines, the terminals, these are the assets that effectively facilitate the movement of that energy from its point of production. Think of the oil well to the actual end user, so think about if you still drive an internal combustion engine in your car, it's the gas station filling up your gas tank. And so these assets and the businesses that own them, the attributes I like to focus on or talk to people about are that they're strong competitive moats, you don't just go build a pipeline on a whim. These businesses have firm contracts, they generate stable cash flows, and they generate, as a result, significant levels of free cash flow. Which in our opinion make them very attractive investments for investors, in particular, income-seeking investors like what I think we generally associate with looking at closed-end funds.

CHUCK JAFFE: I may have buried the lead here as well, because here I am talking to you and we wanted to jump right in on the subject matter. But in calling you by your title, co-head of energy infrastructure, I didn't talk about the fact that Kayne Anderson Energy Infrastructure, which is ticker symbol KYN, and Kayne Anderson NextGen Energy & Infrastructure, KMF, are merging, they're going to go under the ticker symbol KYN. And I'm just curious, the merger, you had two funds covering the space, what are the benefits of being together given the opportunity set you see?

JIM BAKER: Yeah. No, that's great, and so that is a proposed merger we announced a little over a month ago, we're still in the review process with the SEC, we have a shareholder meeting schedule for late June. So it's proposed, certainly something that we are going to seek to have our shareholders approve this summer. But to your question, really it's about combining, getting size and scale, having one product available for investors to capture on what we think is a really favorable outlook, again, for the next five or 10 years. And what we think is a nice way for income-seeking investors that like the energy story but want to play it in a little bit more of a defensive nature, so these companies don't have the same exposure to commodity prices, again, long-term contracts, and generate stable free cash flows. So we think it's a nice way for people to capitalize on a trend but perhaps not take on the same volatility that they would if they bought an exploration and production company which has meaningful direct exposure to the whims of commodity prices.

CHUCK JAFFE: Let's bring this back to, well, not so much the market, but the economy now. Everything you said certainly should make somebody feel pretty good about the prospects for energy infrastructure investing, but we do live in a time where there's some geopolitical concerns, there's just some plain old political concerns right now in this country, and then there's economic concerns like what happens if we have a particularly hard landing or a deeper recession than some folks are expecting? How does energy infrastructure ride out those concerns?

JIM BAKER: It actually, in our opinion, rides out those concerns reasonably well. Certainly no sector of company is immune to economic activity, but again, fixed-fee contracts, stable cash flows. The other thing I'd note is that there are, in a lot of their contracts, inflation protections, or said differently, the rate that they charge actually increases often on an annual basis by the rate of inflation, and so you've got some real defensive attributes in our mind. The other thing I'd point out is that I talked about 2020, which was never before seen in the energy industry, these companies in energy infrastructure, so the top 10 companies that we invest in, their cash flows were down less than 5% in 2020 versus 2019. And so it's just a good way to illustrate, I would say, once in a lifetime, once in a generation event, and yes, cash flows were down modestly but not nearly as much as you would think given the events that occurred.

CHUCK JAFFE: Jim, this has been really interesting and fun, thank you so much for joining me on The NAVigator to talk about. I look forward to doing this with you again down the line.

JIM BAKER: Chuck, I really appreciate the time, it was great to talk to you.

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podcast is new every Friday. Next week Matt Freund from Calamos Investments will be here, come back for that and in the meantime, happy investing everybody.

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