Energy transition: the opportunity set is changing

As sector matures, experienced investors can diversify their return streams

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Energy markets are mutating at a breath-taking rate: for experienced investors who understand the risks, we think the returns on offer will comfortably outperform those of traditional assets on a risk-adjusted basis.

While Mirova's early investments were focused on simple – but effective – greenfield renewable energy strategies such as solar and wind projects in mature economies, our remit has considerably widened over the years. Our portfolio is increasingly populated by evolving technologies such as storage, biogas, hydro, hydrogen and electric mobility. And our focus is shifting from building facilities which supply energy directly to the grid to B2B projects, such as energy storage and installation infrastructure for electric vehicles.

In other words, we have expanded our remit to energy transition.

Regulation driving energy transition

Regulation for energy transition is driving change worldwide. The European Commission's 2030 Climate Target Plan envisages an EU-wide assessment of national energy and climate plans and will incorporate a new emissions reduction target of at least 55% by 2030, compared to 1990 levels.

For many years, China has led the world in construction of new wind and solar facilities. Under the 12th Five-Year Plan, it set ambitious targets for wind and solar, supported by subsidized feed-in tariffs.

In the US, the trend towards clean or renewable energy is also accelerating despite reluctance at the Federal level. Fourteen states, plus Puerto Rico and the District of Columbia, have 100% clean or renewable energy targets.

COVID-19 has only reinforced the sense that the tide is turning, and a number of countries have already reaffirmed their commitment to energy transition.

France recently submitted its national energy and climate plan (NECP) 2030 to the European Commission. The country will target 33% renewable energy in its energy mix by 2030.

France joins Austria, Denmark and the Netherlands as countries pledging more recovery funds to green energy than to CO2-heavy industries . Meanwhile, South Korea has approved $61 billion of green economic stimulus and Australia has pledged A$1.9 billion over ten years to develop clean technology.

Diversification: biogas

To be robust, all investment portfolios should be diversified and the expansion of the energy transition sector now offers this potential.

Consider our recent transaction in biogas, a sector which barely existed a decade ago. Together with French utility company Engie we acquired a 50% stake in Dana Gaz, which runs nine operating units, including seven biomethane production plants and two cogeneration plants.

The partnership enables Engie to accelerate the development of its biomethane projects with the aim of producing 5TWh of biomethane of French origin by 2030. It is now the leading biogas operator in France, active across the whole value chain, working alongside local authorities, farmers and industrials.

The risks could have been considered high for some third-party investment partners, but we were involved with the construction of some of the assets so, crucially, the risks were well known to us.

Diversification: smaller markets

The Engie partnership is a good example of diversification by technology.

Our recent wind farm transaction in Poland, on the other hand, is an example of geographical diversification. Mirova provided equity financing to Akuo, a global renewable energy power producer and developer, to finance three wind power projects in Poland.

These projects won the tariff tender launched by the Polish government in late 2018. The Polish government's aim was to reduce its dependence on imported fossil energy, and achieve the minimum threshold of 15% of renewable energy in its energy consumption by 2020.

The transaction was a key landmark for Mirova as it represented our first investment in Poland. Importantly, the Polish Government's energy support scheme provided considerable risk mitigation.

Diversification: hydro

Mirova's hydro-electric transaction in Portugal, one of the largest hydro transactions seen in the European market, is another example of how to invest in the fast-evolving energy transition sector.

We like hydro assets as a rule, in particular the ones with pumping capabilities, as they are a capacity asset which are a good addition to wind and solar. You can store hydro power and inject it into the network when it is needed. Although the price of solar power is very low in the middle of the day, it rises considerably when the sun is not shining. At these times hydro power comes into its own and can command good prices.

The deal Mirova helped finance was the purchase of half a dozen hydroelectric dams from Energias de Portugal (EDP). The deal, worth €2.2bn, was financed by a consortium comprised of Engie, Crédit Agricole Assurances and Mirova. The dams are situated in the Douro river area of northern Portugal, where grapes are grown for Port wine.

An additional benefit of such a large deal is that we were able to bring co-investors on board. These investors prefer direct investment in assets but, at the same time, need guidance and due diligence capabilities from experienced fund managers.

New technologies, old heads

Experience is needed not just to perform analysis and due diligence, but to access and execute deals in a sector which can be complex to navigate. This necessitates a wealth of contacts and deep experience of transaction types.

Our first foray into renewables was back in 2002 and, over the years, we have hired senior people from green energy development companies and utilities which enables us to take on more development risk. Every member of Mirova's 15-strong renewable energy team has a strong background in renewable energy, as well as core skills such as project financing, technical, project development, investment management and ESG analysis.

These skills and experience help to create good industrial relationships where industrial players and operators learn to trust how we do things. Trusting industrial relationships lead to strong pipelines of deals, through referrals and repeat transactions.

Limited partners attracted by frontier investments

Experience of established financial partners is increasingly matched by the risk appetite of limited partners, many of whom are old hands in this market now and are comfortable with taking more development risk.

The rising emphasis by policymakers on green energy means the sector should continue to grow even if there are fluctuations in energy demand due to economic volatility. Furthermore, renewable energy is seen as a hedge to the risks of exposure to stranded assets in other parts of investors' portfolios.

Returns are private equity-like in nature, except that Mirova's strategy mitigates the J-curve effect by investing some of its capital in brownfield projects, which are operational and can generate immediate income to investors.

Huge pools of private capital needed

Energy transition represents a massive change for the global economy and it requires a vast amount of capital to execute.

We think opportunities for experienced investors in the renewable energy sector will constantly evolve, providing exciting, diversified return streams for investors.

1 Source: Bloomberg New Energy Finance - https://about.bnef.com/