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Listed Renewable Energy Infrastructure – risks and opportunities

Research & Insights

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Q: What is the renewable energy opportunity within Global Listed Infrastructure?

A: With most of the developed world experiencing an energy crisis of varying degrees, investing in renewable energy has never been more in focus. The investment opportunity set for companies focused on renewable energy is continually expanding due to the soaring costs of fossil fuel-based alternatives and also an unwavering long-term commitment to decarbonise developed economies. And now there is a new focus, that of energy independence stemming from Russia's invasion of Ukraine. This has further exacerbated the situation and added even greater impetus to invest in renewable energy in Europe as it seeks to wean itself off Russian gas. Accelerating investments in renewable energy is Europe's path to energy independence, or as Kwasi Kwarteng, the UK Secretary of State for Business, recently said: "This is no longer about tackling climate change or reaching net-zero targets. Ensuring the UK's clean energy independence is a matter of national security."

Q: How is Europe reacting to the war in the Ukraine in terms of energy supply?

A: The European Commission outlined the REPowerEU Plan, in response to the global energy market disruption caused by Russia's invasion of Ukraine. A key plank of REPowerEU is to accelerate the roll-out of renewable energy to replace fossil fuels together with other initiatives aimed at reducing energy and gas consumption and diversifying sources of energy. In doing so, the EU is seeking to greatly reduce its dependency on Russian gas and oil. In terms of renewables, the EU proposes to increase the headline 2030 target for renewables from 40% to 45% of the generation mix (vs ~20% in 2020). We have also seen individual EU countries greatly increase their renewable energy targets in response, particularly in offshore wind. As a result, Ørsted, a global leader in offshore wind development, forecasts that under an accelerated scenario, there will be 230GW of offshore wind generation in the EU and UK by 2035, compared to ~25GW currently in operation.

One of the key challenges of investing in renewable energy in the EU has been the slow and complex approval processes for renewable energy projects. The EU is asking member countries to significantly shorten and simplify approval processes. Anecdotally, we are already seeing a response from some member countries in this regard, but this is an area to monitor and a key risk in terms of the EU achieving its ambitious goals.

Q: What about the USA and renewable energy?

A: Over in the US, the energy transition is continuing at great pace. The energy transition in America is being driven by the ambition of states to achieve levels of energy independence, and the relative attractive economics of renewable energy compared to fossil-fuel based power generation alternatives. With sustained commodity price pressure this has not changed, if anything price pressure has accelerated the move to new energies. Recent developments in the US have seen moves towards extending and widening policy support for renewable energy at a Federal level, however this will remain in flux until legislation has been successfully passed. We maintain a watching brief on these developments and how they can benefit our portfolio. Any positive developments in this regard would likely hasten the energy transition in the US, and the growth potential of the sector.

The US is currently experiencing supply chain disruptions in renewable energy. Offshore wind investments have also been impacted given requirements to use US vessels, regulatory approval delays, higher commodity costs and supply chain immaturity compared to Europe and the UK. And up until a decision by the US Federal Government to declare a 2-year tariff exemption, solar investments were being impacted by a US Department of Commerce investigation into anti-dumping of solar panels from Southeast Asian countries that source components from China. These are, in Ausbil's view, short-term issues that, while requiring monitoring, are unlikely to alter the long-term growth potential in the US and the resulting investment opportunities.

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Q: Can you discuss a stock holding that is showing leadership in the renewables space?

A: NextEra Energy is a key portfolio holding in Ausbil's Essential Infrastructure Fund and has been since the fund's inception. Together with owning Florida Power and Light, one of the largest, best performing and attractive regulated utilities in the United States, NextEra Energy is a global renewable energy powerhouse focused on onshore wind, solar, batteries and green hydrogen in North America.

In NextEra, Ausbil sees a very attractive long-term investment due to its unparalleled growth prospects in renewable energy, its exceptional track record of execution, its low-risk business model and strong balance sheet, and its unique scale benefits in renewable energy, combined with a best in class regulated utility in Florida. Importantly, NextEra's guidance to the market does not assume there is any legislative success at a Federal level to further support renewable energy. Thus, any such developments would represent upside (potentially material) to NextEra's growth potential and valuation.

NextEra is spearheading the decarbonisation of the US economy by decarbonising itself, and also leading the decarbonisation of the power sector. It just recently announced a plan to reach Real Zero by no later than 2045 – a commitment to eliminate all scope 1 and 2 carbon emissions across its entire operations and at zero incremental cost to customers. Real Zero means that no carbon offsets are utilised to meet the emission commitments unlike net zero commitments.

NextEra estimates a U$2 trillion investment opportunity to decarbonise the US power sector, and U$4 trillion to decarbonise the full economy over the period to 2050. NextEra is incredibly well placed to benefit from this extraordinary investment opportunity over the coming decades.

Q: What is the Ausbil view on renewable energy?

A: Ausbil's Essential Infrastructure approach to investing means it is a relatively low-risk way for investors to gain exposure to this exciting secular growth opportunity. Few renewable energy companies globally currently meet our Essential Infrastructure criteria – this is mostly due to the fact that many companies involved in renewable energy may also be involved in other activities, have material competitive market (or merchant price) exposure, or highly levered balance sheets. Companies focused on the technology or commodity aspects of renewable energy do not meet Ausbil's Essential Infrastructure criteria. Of those few companies that meet Ausbil's criteria, we are currently seeing increasingly attractive investment opportunities around the world due to high equity market volatility, concerns over short-term supply chain disruptions together with renewable energy companies being somewhat caught up in the rotation from growth to value.

Another way Ausbil's Essential Infrastructure Fund gains exposure to this thematic is through the regulated utilities. In North America, for example, many of the regulated utilities are accelerating the move away from fossil-fuel based generation towards renewable energy and are also investing heavily in their electricity grids. Likewise, in Europe and the UK, the owners of 'poles and wires' infrastructure are undertaking enormous investments to support the growth in renewable energy and the decarbonisation of their economies.

Q: What are the investment opportunities in Australia in renewable energy?

A: For investors focused on Australia, it is far more challenging to gain direct exposure to this exciting thematic. There is no longer any ASX-listed pure-play exposures to renewable energy. Further, with the take-overs of both Ausnet Services and Spark Infrastructure during 2021, there is no ASX-listed owner of electricity grids like there are in other parts of the developed world. There are many companies on the ASX involved in the energy transition, either through a commodity or financing exposure, or through providing engineering and associated services. Others like AGL Energy and Origin Energy are also directly involved but complicated by their substantial ownership of coal-fired generation assets that also operate in competitive markets. Through the lens of Essential Infrastructure, none of these companies meet our criteria and as a result expose the investor to a different risk and return profile that infrastructure investors are typically seeking to achieve. In our view, the best risk-adjusted way to play the unstoppable rise of renewables, and take advantage of current valuation disconnects, is to look globally for companies through the lens of Essential Infrastructure.

Q: What are the most significant risks that investors need to be aware of?

A: While the long-term investment thematic regarding renewable energy is undoubtedly positive, investors are currently navigating a myriad of risks and challenges. These include, for example, supply chain disruptions, cost pressures, broader affordability and reliability of supply concerns, intensifying competition and growing risk of regulatory and political intervention.

Additionally, most renewable energy companies have also been caught up in the savage equity market rotation away from growth – with higher bond yields impacting views of long-term valuations. As long-term investors in the asset class, we are seeing these challenges as creating more attractive long-term investment opportunities, but we are also alive to the challenges in front of us.

Risks of regulatory and political intervention is always top of mind for infrastructure investors. These risks are most acute at the moment due to the significantly worsening energy affordability situation in Europe and the UK in particular. We have seen for example, the Spanish Government impose windfall taxes on electricity and renewable energy companies whose profits have, at least indirectly, benefited from the substantially higher gas prices feeding into higher electricity prices. The UK Government has imposed windfall taxes on oil and gas companies, but has to date decided not to impose similar taxes on power generators and energy retailers. This has the potential to impact the near-term earnings of renewable energy companies but more importantly alter perceived political risks feeding into cost of capital considerations.

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