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Generating next-level returns

With returns for vanilla renewables under pressure, managers are refining their strategies to deliver superior performance. Six industry professionals tell Amy Carroll and Anne-Louise Stranne Petersen what that entails

Optimism in the renewables sector has dipped, according to a survey conducted by global energy advisory business DNV – 78 percent of respondents express confidence in the industry's growth prospects for the coming year, down from 87 percent, amid ongoing geopolitical uncertainty, supply chain challenges and rising costs.

Benjamin Kennedy, managing director at Ardian, however, says he is more optimistic today than he was previously, precisely because some overexuberance has come out of the market. "Yes, there are pressures in terms of supply chain constraints, inflation and the rising cost of capital, but those pressures were all likely to materialise over time. That investor expectations now reflect that reality means investment will be on a sustainable trajectory going forward."

Kai Rintala, managing director at Taaleri Energia, adds: "Clearly, there are some factors working against the industry right now, but there are also a lot of tailwinds. Panel prices are coming down. Battery prices are down. The tragedy of the war in Ukraine also means that power prices in Europe are probably going to be higher for longer.

"Renewable power, of course, is the fastest and cheapest way to achieve energy security. So, whilst debt is expensive and return targets are higher, there are a lot of positives as well."

Meanwhile, almost three-quarters of respondents to the DNV survey say that they need more government incentives in relation to renewables – despite the historic funding packages that have been recently put in place in both the US and Europe.

Others believe government initiatives would be better off focused elsewhere, however. "We are now in a position where investments in wind and solar are economical without government support," says Joost Bergsma, global head of clean energy at Nuveen Infrastructure. "I don't think incentives are required on the hardware side. Where I'd like to see more support is around system architecture. We are not there yet in terms of storage. There is still a lot more to be done on the grid. We need interconnections between European countries. Those are the areas where I would like to see government directing capital and harmonising regulation."

Keith Gains, managing director and regional leader for the UK at Quinbrook, agrees. "Renewables are now extremely competitive. We can build out on the back of corporate PPAs or, in the UK, the contract for difference mechanism. We don't really need support for mainstream renewables technologies," he says.

The streamlining of approvals processes remains a top priority, however. "In order to hit climate targets, we are going to have to build a lot of new capacity and the development process in Europe is still frustratingly slow," says

Bergsma. "That is an area where policy needs to be directed."

"The most important and urgent change we need is the simplification of processes. Reducing bureaucracy is paramount to achieving Europe's 2030 targets," adds Nicolas Rochon, founder and CEO of RGREEN INVEST. "While it's important to set targets for renewable energy capacity, in order for these targets to be achievable, European nations have to adopt an enabling development framework. Renewable energies no longer need subsidies as the technologies are competitive, but a clear path for deployment."

Peter Schümers, partner and co-head of investments at Energy Infrastructure Partners, meanwhile, says his firm looks for investments that do not rely purely on incentives or subsidies and that are positioned to thrive economically in a healthy market. "Rather than subsidies, we would prefer lawmakers to focus their efforts on power market design and investment in grids, which would help to reduce cannibalisation risks."

Cannibalisation and storage

Battery storage is clearly a critical component to circumnavigating the cannibalisation problem. But investing in batteries comes with its own challenges.

"Investment in batteries is largely a merchant play and the sector is really struggling, evidenced by the performance of some of the listed yieldcos, given the almost complete lack of volatility we have seen over the past 12 months," says Gains.

"That makes us nervous when looking at investing in long duration energy storage, and it is certainly an area where government support would be helpful. The way we deal with the risks now, however, is through diversification. By spreading our risk across different forms of generation and grid support with different cashflow profiles, we are able to dip our toe in the water as far as storage is concerned."

Nuveen Infrastructure, meanwhile, has recently made battery storage

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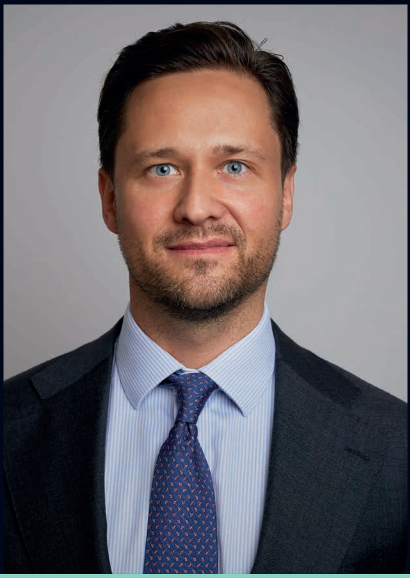
PETER SCHÜMERS
Energy Infrastructure Partners

Nicolas Rochon
founder and CEO, RGREEN INVEST

Rochon has over 20 years' experience in infrastructure asset management, with a particular focus on renewable energies and more recently energy storage. After co-founding La Financière de Champlain, he founded RGREEN INVEST in 2010 with the mission to promote renewable energies, initially as a consultant and since 2013 as an investor, providing financial solutions to the entrepreneurs driving the transition, through the INFRAGREEN strategy.

Benjamin Kennedy
managing director, Ardian

Kennedy joined Ardian in 2022, to head the Ardian Clean Energy Evergreen Fund. He was previously head of onshore M&A and business development at Ørsted and has also worked at Bank of America and Robert W Baird.



Joost Bergsma
global head of clean energy, Nuveen Infrastructure

Bergsma serves as global head of clean energy at Nuveen Infrastructure, formerly Glennmont Partners where he was CEO and managing partner. Prior to joining Glennmont, he held senior positions at BNP Paribas, ABN Amro and SG Warburg & Co.

Peter Schümers
partner and co-head of investments, Energy Infrastructure Partners

Schümers has more than 17 years' experience investing in utilities and infrastructure, focusing on the renewable energy sector since the industry's early days. He has led a number of successful transactions for EIP including the acquisition of a stake in Repsol Renovables.

Kai Rintala
managing director, Taaleri Energia

Rintala has been managing director of Taaleri Energia since 2016 and has over 20 years' experience in the infrastructure industry. He previously worked for KPMG in Helsinki and London, advising infrastructure clients.

Keith Gains
managing director and regional leader for the UK, Quinbrook

Gains has over 17 years' experience in the clean energy sector and is responsible for leading Quinbrook's investment activities in the UK. He previously worked for Capital Dynamics and Novera Energy.

investments in Italy. The firm's approach to risk mitigation around batteries is colocation, according to Bergsma. "We prefer to colocate either on a virtual or physical basis. Italy is an important solar market for us, so it makes sense to have battery storage exposure as well."

PPAs are also critical to Nuveen Infrastructure's approach. "You can't completely mitigate cannibalisation risk with a PPA, but predictable cashflows are important for our investors," Bergsma explains. "Luckily, the PPA market has grown hugely in terms of both utilities and corporates over the past couple of years. Finally, we take a portfolio approach, using IT systems so that we can see exactly how much wind and solar we are producing at any given point in time. That enables us to manage our pricing across the portfolio, in order to optimise revenues."

Kennedy adds: "The best way to hedge short-term cannibalisation risk is through diversification and offtake contracts. Battery storage is predominantly a merchant asset, however. I don't think it makes sense as a contracted asset, at least in the private markets space. But then that gives you a different cashflow profile, relative to your generation assets that may be facing cannibalisation risks."

Indeed, while cannibalisation is a risk, it does create an opportunity for storage in the long-term. "There are insufficient grid and storage solutions in many markets," Schümers says. "That is resulting in rock bottom energy prices a lot of the time. We can also address this risk through diversification. We like to invest in platforms in order to create broad diversification across geographies and technologies, combining wind, solar and storage, as well as hydro and pumped hydro storage, to really mitigate cannibalisation risk."

Merchant risk

While PPAs clearly have an important role to play in creating an infrastructure-like risk profile for renewables,

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> **BENJAMIN KENNEDY**
> **Ardian**

investors are balancing this cashflow visibility with the potential to opportunistically play the market by taking merchant risk. Risk appetites vary significantly, however.

RGREEN INVEST targets 30 percent exposure to merchant risk across its projects. "We selectively maintain exposure to merchant risk across our investments, ensuring a sound technological mix across such portfolios including solar, wind and storage, in order to secure the best conditions for optimising the electrons," Rochon explains.

"We aren't looking to increase our target for merchant exposure due to the additional volatility this would introduce, and we do not anticipate significant shifts in electricity prices warranting an increased exposure to merchant risk."

"We are slightly more risk averse," says Gains. "We typically look for an 80:20 split in terms of long-term contracts and merchant exposure. In part,

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> **KAI RINTALA**
> **Taaleri Energia**

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> **NICOLAS ROCHON**
> **RGREEN INVEST**

it depends on how reliant you are on debt. There are very few banks in the UK that are prepared to take merchant risk as far as batteries are concerned, for example. Others want to see some sort of price floor in a route to market agreement. You pay a lot of money for that price floor, even though as far as we are aware, no provider has actually paid out, given how flat markets have been."

Bergsma agrees that the question of how much merchant risk you are willing to take will depend on the technology concerned.

"I would say that with a highly capital-intensive offshore wind farm, for example, taking merchant risk is not in line with our strategy, but with solar, where timelines are much shorter and the capital at risk is lower, our appetite is significantly higher. There can be tactical advantages to taking some short-term risk in those situations. Our preference remains 10-12-year PPAs – or even longer. But we are well equipped to leave positions open from time to time when it makes sense given market volatility."

Taaleri meanwhile is at the more aggressive end of the spectrum when it comes to merchant exposure, contracting just 50 percent of its production. "That requires you to be extremely pessimistic in your base case in terms of power price projections," Rintala explains.

He adds that Taaleri's batteries are fully merchant. "We just don't see the point in giving away value to someone else. But if you are taking this approach, then I agree, you have to accept far lower levels of leverage. You also need to ensure you have the right people in place who can see events unfolding before they happen."

Kennedy says: "Corporate PPAs are still underdeveloped in Europe compared to North America, so there are still trends that will allow developers and investors to continue to contract revenues. But overall, the market is only going to become more merchant over time. The focus therefore needs to be less on avoiding merchant risk and more on pricing it correctly."

Single assets versus platforms

Another way that renewables investors are responding to the challenges of dampening returns is through the pursuit of platforms as opposed to single assets.

"It is very important to invest in platforms in the current environment in order to generate diversification. Single assets bear more concentration risk," says Schümers. "In addition, with platforms you are able to attract better suppliers, better financing conditions and better offtake conditions. On top of that, you have longer-term value creation than in closed-ended single assets that you know will depreciate to zero."

"We're not shying away from investing in single projects, but we are getting involved earlier, which means we are taking a bit more development risk," adds Gains.

Taaleri, meanwhile, takes a different approach. "What we do to elevate our returns is to build a large portfolio of development projects," says Rintala. "Then it's a Darwinian process where we end up building 15 to 18 of the best projects. Naturally, you need to have the right people to execute on this kind of strategy. In addition to investment professionals, we have development managers, construction managers and technical asset managers. That is our approach to value creation."

Indeed, the renewables landscape is undoubtedly becoming more complex in general, and managers are responding by bringing more expertise into their teams.

"The days of investing in vanilla renewable energy deals are over. In order to create value in the current context, you have to be a specialist with the necessary know-how," says Rochon.

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> **KEITH GAINS**
> **Quinbrook**

"You have to be able to combine different technologies that complement each other, incorporate energy storage, and really master the route to market options in order to monetise best the green electrons. Given the critical importance of having the necessary skills to address to the current set of challenges, 50 percent of our team comes from the industry."

"We have always been a pure energy infrastructure firm, with a strong focus on energy transition, and so we are all essentially experts in the sector," adds Schümers. "Having said that, over the past 10 years we have built up additional specialist capabilities. We have technical experts, for example. We have commercial experts. We have an ESG team. We have an internal financing team and a team of regulatory experts. The sector has become a lot more complex and so it requires that level of expertise to really be successful and generate alpha."

Taaleri, meanwhile, has taken an interesting approach to hiring differentiated talent. Two years ago, the firm recruited a head of power markets with 20 years' experience of power trading in the utilities sector. "Thinking of our funds as utilities has helped us bring a completely different mindset to the opportunity set," says Rintala.

Political risk

Regardless of strategy, one challenge that all renewable energy investors must take into account is political risk. This has become particularly evident given the windfall taxes imposed when power prices soared in the wake of Russia's invasion of Ukraine.

"Political risk is very difficult to control. The only real answer is diversification," says Rintala. "In some ways, I am relieved that power prices have come down, in that it removes the temptation for politicians to intervene with the marketplace."

Upcoming elections in the US are also giving pause for thought, as investors evaluate the extent to which the Inflation Reduction Act could be rolled back. "I am personally of the view that the IRA is now so heavily embedded in the system that it would be next to impossible to reverse. What I am potentially more worried about is protectionism," Rintala says.

Bergsma adds that a lot of recent elections have resulted in a shift to the right. "Having said that, whilst there has been a lot of potentially troubling rhetoric going into these elections, actual changes that are detrimental to the clean energy sector have been extremely limited.

"The major reason for that is that renewable energy is the cheapest and fastest way to deliver energy security. Whilst it is certainly helpful to have politicians with positive attitudes to the sector and policy is important, this is an industry that is going to continue to grow, regardless of who is in power."

Schümers agrees. "If Europe wants to reduce its dependency on the Middle East and Russia then the obvious solution is to invest more in renewable energy. And whilst there is some uncertainty in the US, the IRA was a bipartisan act, supported by many red states, where jobs and economic development are dependent on this sector."

Gains says: "I think it's important to remember that it isn't just political support that we rely on. We now have a huge amount of corporate and public support. The whole of society seems to be behind decarbonisation and that is the best mitigant for political risk that you can have." ■