Rise of the corporates

Stephane Wattez-Richard, investment director at Conquest, on how corporate demand for clean energy is reshaping the investment environment

Q What are the biggest changes you have seen in the energy transition market over the past few years?

Stephane Wattez-Richard: We are moving away from assets with subsidy-backed revenues and towards a more merchant world across most Western European markets. It is a challenge in the short term because of the volatile merchant electricity prices, and it has become more challenging for investors to find transactions with secured long-term revenues on completion. But fundamentally it represents an opportunity. Investors are mitigating that merchant risk by soliciting power-purchase agreements – from utilities, but also from corporate offtakers – in a not yet completely structured market.

Initially, demand came from the GAFAs and a few dozen more, who were keen to power data centres with green electrons. But corporates– and, in particular, those operating in electro-intensive industries, including chemical, pulp and paper and steel and metal – are also accelerating their shift from conventional power sources to renewables with fixed price terms attached. They are doing this primarily to mitigate the increased power price volatility they face. But they are also doing it to act against climate change, which is what their stakeholders are demanding. Merchant risk is accelerating the maturity of this corporate PPA market.

Q What impact is the rise of the corporate PPA having on deal structuring?

SWR: These offtakers now have a seat at the table early in the investment process. It brings more complexity – there are around 20 ways of structuring a PPA – and your future revenues depend on the terms you are discussing with these increasingly key stakeholders. You bring more corporate counterparty risk to your deal.

> We have always limited leverage in our projects. The financing profile we favour matches the constraints imposed by PPAs"

It also impacts the level of leverage you can put into a transaction. A PPA will generally not cover 100 percent of electricity production. It will often fall somewhere between 30 and 70 percent. That means you can put less debt into a deal than would have been the case in the past, when many renewable projects were highly leveraged. We have always limited leverage, so we can distribute yield from our projects early on to our investors. The financing profile we favour therefore matches the constraints imposed by PPAs. But for those that have historically pursued highly geared deals, this is no longer possible.

Q Which sectors are you primarily focusing on?

SWR: Our investment strategy is aimed at sustainable infrastructure. We are investing in assets that mitigate climate change and we keep a strong focus on renewables, of course. But we are also investing in other assets that can help accelerate the energy transition. The more renewables or distributed energy assets you find on a local electricity grid, the more intermittent electric power becomes, and the more unstable the grid. Energy storage assets help mitigate intermittency and maintain grid stability, and they will help in managing grid congestion. However, private investors face the challenge of finding the right business models with adequate risk-adjusted returns.

Q What about opportunities to assist corporates with their energy efficiency?

SWR: Although industrial players are

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increasingly looking to source green energy, some are also electrifying more of their manufacturing processes to make them less dependent on fossil energy, which creates additional investment opportunities. These companies are looking to re-invest in their plants. We are working with those corporates to help them accelerate their transition.

Q Which regions in Western Europe are the most attractive right now?

SWR: Northern Europe is attractive to us, with its sophisticated transmission and distribution operators, and its strong track record on renewables and energy efficiency coupling. Each European market is at a different level of maturity regarding its renewable targets. Depending on the upgrading of its grid, each also brings its own challenges. The timing of the phasing out and decommissioning of nuclear power will impact the speed of the energy transition in France. Germany, where there are a high level of renewables already, will accelerate further, but its market is expected to remain extremely competitive.

There is a meaningful difference between the markets in light of the quality of the local grids and their ability to deploy grid connections quickly enough to address the accelerated deployment of renewables. This is a common bottleneck we face in several markets. Ireland for example, which is likely to deliver on its high renewables goals at 30 percent in 2020, is working to upgrade its grid sustainably and thereby continue spearheading its energy transition.

In spite of those individual challenges, the stable market and regulatory environment are among the reasons that we and our investors like this region.

Q Do you invest in Southern Europe?

SWR: Portugal, Spain and Italy remain attractive and deep markets in wind and solar. Even though competition has been high, we see the opportunity to go after smaller assets and aggregate them into larger portfolios, which is a strong driver of value creation.

Q Are you seeing more competition from corporates on deals, as well as corporates supporting transactions with PPAs?

SWR: They are not direct competitors. Large energy management corporates, usually former local incumbent utilities and their main challengers, are shifting from traditional 'thermal' assets to renewables. These corporates are eager to acquire strong pipelines of renewable assets and lead consolidation of the European developers market. Some keep these assets on their balance sheets once they have been developed. We usually partner with those that would rather put those assets back on the market. The synergistic advantages these energy companies bring mean they can be highly competitive on big deals across the development and operating asset management value chain. But there is still room for us as, once the asset is fully developed, as we have a different cost of capital.

> "We are facing a revolution as three sectors – energy, digital and transport – converge"

Q What does the rise of the corporate PPA mean for the long-term future of the assets you invest in?

SWR: It is good news as it confirms the long-term nature of the assets we back. We can clearly see value in these assets beyond the next 20 or 25 years. Their performance will have decreased, of course, and there will be a need to retrofit or re-invest in the energy production plant itself at some point. But these assets are usually sitting on good locations with long-term leases and are already connected to the grid. Once that initial PPA period has expired, there will most certainly be a window to seek additional secured revenues, and financing, for the years ahead.

It is always challenging to put a number on this type of value so far in advance, but we see it as very unlikely that these assets will be dismantled. A few years ago, they would have been seen as having a defined lifespan. But as electro-intensive companies shift towards sourcing greener energy, they are increasingly seen as evergreen assets.

Q What comes next for the energy transition process in Europe?

SWR: We see a strong convergence between the different subsectors that make up the sustainable infrastructure investment ecosystem, largely because of the development of data management and digital technologies. In addition, electromobility has already become an important theme as the integration of electric vehicles to the grid creates new opportunities for investment. The expected use of smarter energy data management systems, accelerated by the expected roll-out of AI techn ologies, presents an unprecedented opportunity to manage risk, short- and long-term production, and performance forecasts even more effectively, and to generate more value.

We are facing a revolution as the energy, digital and transport sectors converge. This is an area we will be concentrating on heavily over the next few years. ■