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Long-Term Investors See Value in the Renewables Space

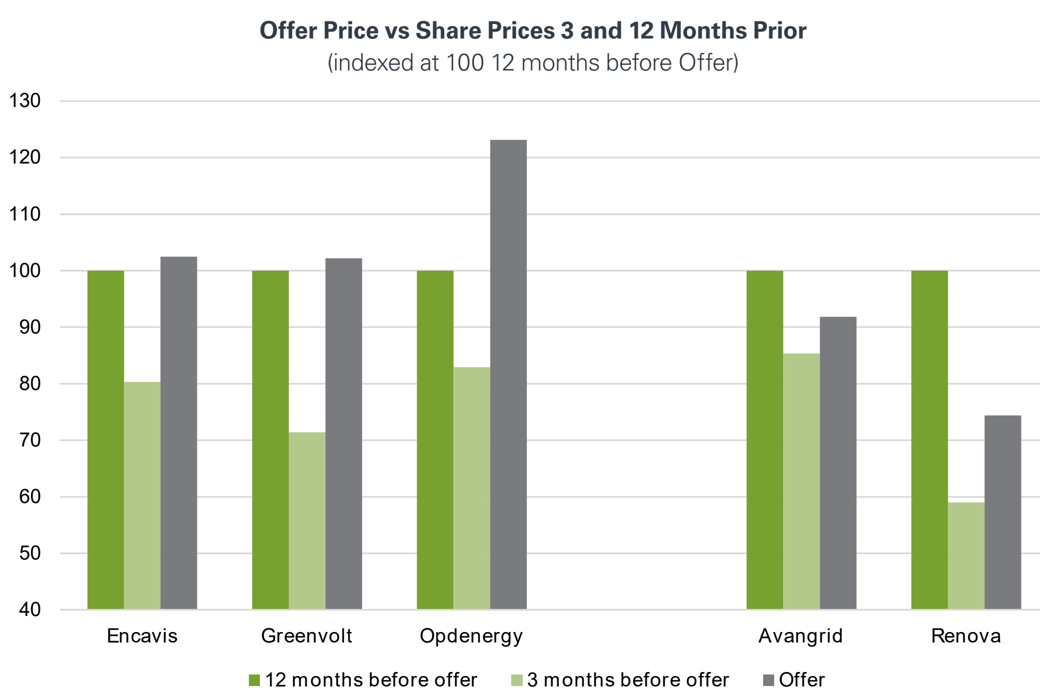
May 2024

Over the past few quarters, following a confluence of headwinds for the renewables power generation sector, we believe investors questioning growth and return opportunities have pushed down valuations. The sector had experienced a few years of cheap capital, fuelling unabated growth for clean power as the market grew confident in perpetually declining cost curves of power generation equipment that would support attractive returns. Then we believe, fast-rising interest rates, equipment cost inflation and falling power prices raised questions about returns and reduced confidence in the renewables companies' capacity to grow and the value of growth.

While the stock market has been sceptical, we have more recently seen private equity, utilities as well as renewables companies themselves conclude that valuations were too attractive to ignore. As such, we have seen private equity making takeover offers, utilities buying out minority owners or investing in listed renewable companies as well as management buying back their own shares.

In terms of M&A, Antin (Private Equity) made an offer for Opdenergy (Spain) and KKR (Private Equity) made an offer for Greenvolt (Portugal) and Encavis (Germany) while Iberdrola (Spain) offered to buyout the minority owners in Avangrid (US) and Tokyo Gas (Japan) took a 15% stake in Renova (Japan) (Exhibit 1).

Exhibit 1: Recent M&A Transactions



Why is this happening and why are we seeing an acceleration of these transactions in the past few months?

One can claim it is purely opportunistic with bidders taking advantage of short-term stock market dislocation. Indeed, some weakness in the first quarter of 2024 certainly offered an opportunity to motivated buyers. However, much value had emerged at the end of the 3rd and beginning of the 4th quarter of last year and we have seen management activate buybacks throughout 2023. As such, we believe that these buyers have found additional reasons for investment:

- First, as the companies continue growing independently from the economic cycle, valuations have compressed and in our view provide an even more compelling value proposition. It is worth noting that the broader utility sector is also trading at unusually low levels with U.S. and European Utilities Sectors trading one standard deviation below their historical absolute and relative PE multiples.

- Second, drawing from their exposure to datacenters, AI and transport and relationships with the leaders in those sectors, bidders have developed a view that electricity demand and green electricity demand in particular will be rising substantially in the coming years, making renewables assets and development pipelines more valuable. They might, as we do, anticipate a power cycle on the back of datacenter, EV and heat pumps growth;

- Thirdly, having a longer-term time horizon than stock market participants, we believe their conviction has risen that interest rates will fall in the next 1-3 years, which would give an opportunity to refinance the acquisition and the debt on the targets' balance sheet at much lower rates and therefore create equity value;

As much as the exact timing of the pick-up in M&A activity might be tactical, we believe that the rationale is much more fundamental and we would expect this trend to continue unless public markets recognize the mispricing of shares, based on current fundamentals and relative to the market. It is worth noting that infrastructure private equity funds have raised substantial amounts of money in the past 6 months with Macquarie European Infrastructure Fund 7 reaching EUR 8bn in commitments, Brookfield raising $28bn and KKR $6.4bn for its Asian Infrastructure Fund.

In the meantime, while renewables developers and operators have continued to grow, they have also been frustrated by the lack of market recognition, with many companies launching share buyback programs. What is striking is that this happened in Europe and China, despite the fact that companies face totally different regulatory, contracting, interest rates and power prices environments. In our view, it reflects how top-down sentiment has affected the sector, providing a great opportunity to identify value.

Exhibit 2: Buyback Programs announced in the last 12 months

Buyback Programs				
Company Name	**Country**	**Ticker**	**Date**	**Size**
Bluefield Solar	United Kingdom	BSIF LN Equity	Feb-24	£20mn ≈ 3% of market cap.
Greencoat UK Wind	United Kingdom	UKW LN Equity	Oct-23	£100mn ≈ 3% of market cap.
ERG S.p.A.	Italy	ERG IM Equity	Oct-23	3.7mn shares ≈ 2.5% of total issued shares
China Longyuan Power Group	China	916 HK Equity	Sep-23	10% of total H Shares
Corporacion Acciona Energias Renovables	Spain	ANE SM Equity	Aug-23	4.9mn shares ≈ 1.5% of total issued shares
Concord New Energy Group	Hong Kong	182 HK Equity	Aug-23	10% of total issued shares
Foresight Solar	United Kingdom	FSFL LN Equity	May-23	£10mn ≈ 2% of market cap.
Drax Group	United Kingdom	DRX LN Equity	Apr-23	£150mn ≈ 3% of market cap.

Source: Company announcements, Bloomberg

In conclusion, we are getting strong signals from multiple actors in the market that the renewables power generation sector is very attractively valued. This, in addition to rising momentum for electricity demand, should drive an upward adjustment to valuations of listed shares over time.