

# Ecofin Global Renewables Infrastructure Strategy

## 2Q 2021 QUARTERLY COMMENTARY

### Performance summary

After a volatile first quarter, the core renewables sector continued to see a mixed performance, but the portfolio benefited substantially from its exposure to key holdings in Asia and idiosyncratic stock ideas in developed markets. The strategy returned 1.1% during the second quarter.

As of 30 June 2021

(All total returns in USD)	3 months %	6 months %	1 year	3 years % per annum	5 years % per annum	ITD* % per annum
Strategy composite (net)**	0.9	-1.2	41.2	21.3	15.8	16.5
S&P Global Infrastructure Index	2.1	5.0	22.2	4.7	5.3	6.6

\*30 November 2015. \*\*Strategy composite information provided in the disclaimer on final page.

Source: Ecofin Advisors Limited. Total return includes dividends paid, if any, and reinvested.

**Past performance is no guarantee of future returns.** Returns may increase or decrease due to currency fluctuations.

The additional headwinds that grew in stature during the second quarter was the continued strength in commodity prices, in particular copper and steel, and freight cost, bringing fears of inflation to the forefront of investors' minds. In that context, we think about two aspects of inflation in relation to renewables: Opex inflation and Capex inflation.

#### Opex inflation

First, it is important to note that operating renewable assets incur little ongoing expenses (operation & maintenance) and interest rates are typically fixed, hence the need for an inflation hedge is much less acute than for other infrastructure assets such as toll roads or airports that have higher operating expenses. EBITDA margins for renewables are typically in the 70-90% range versus toll roads and airports in the 30-70% range, and hence inflation-exposed costs for renewables are minimal.

Second, annual inflation adjustments vary country by country, by regulatory framework and when non-regulated, contract by contract. In most cases in emerging and frontier markets, annual contracted electricity prices are adjusted for local inflation. In developed markets, it is a mixed picture and can depend on the technology (wind vs. solar vs. hydro), the scheme and when the assets were built. As inflation is re-emerging, albeit potentially only temporarily, and merchant power prices are up substantially, it is entirely possible that developers will require more systematically that contracted prices include an inflation factor or require higher tariffs than previously expected in order to mitigate the inflation risk.

Finally, regarding activities such as transmission & distribution and merchant power, regulated utilities, especially in Europe, will typically see a full absorption and pass-through of inflation as it is imbedded in the return formula.

#### Capex inflation

We are starting to hear of renewable development capex cost inflation due to rising raw material (steel, copper) and logistics costs. These higher input costs have by definition no impact on any operating asset nor on any asset under construction as those costs are typically locked in or hedged at the time the contract is signed (called FID for Final Investment Decision). These cost inflation risks are related, therefore, to the value of the growth pipeline, in two instances: 1) assets for which a tariff has been approved but the project itself hasn't been confirmed and hence costs have not been locked in, or 2) very competitive auctions/tenders dynamics where realised prices don't allow to reflect rising capex costs.

Inflation will only be an issue for the sector if 1) companies go ahead with lower return projects, as these returns will be lower than originally expected and the value of growth in the company valuation would then need to be discounted; or 2) companies cancel projects or delay approval/construction hoping that costs will come down. These delays would push the growth expectations to the right, potentially creating an air pocket and reducing the net present value of the growth.

Inflation affects all forms of electricity and all sources of energy given where coal, gas, oil prices are compared to a year ago, hence electricity prices on the market (merchant prices) have been rising as well, from +10% year-over-year in the U.S. to +50% year-over-year in France/Germany/UK. In that context, newbuild renewables remain the lowest cost option for adding electricity resources and renewables have therefore headroom to demand higher prices. The only reason this would not happen is either patience from the customers/offtakers who have no pressing need to add capacity and can wait for prices to subside or irrational competition from renewables developers desperate to fill their pipelines to meet their ambitious growth targets. We believe small developers are more at risk in this respect as they are focused on a few markets that might prove unattractive for a while. In conclusion, size and discipline in development will be key.

On the policy front, two developments took place in the quarter that provide structural support to the renewable sector.

First, President Biden held the Climate Summit. Forty political leaders and countless other business leaders gathered for the White House Climate Summit and increased their commitments to decarbonisation.

- China: limit the increase in coal consumption over the 14th five-year plan period (2021-2025) and phase it down in the 15th five-year plan period (2026-2030)
- Japan: 46% reduction in emissions from 2013 levels by 2030 equivalent to a 40% from 1990's level
- UK: 78% reduction in emissions by 2035 from 1990's level
- U.S.: 50% reduction in emissions from 2005 by 2030 which is equivalent to 42% from 1990
- Canada: 40-45% reduction from 2005 by 2030 which is equivalent to 34% from 1990
- Germany: double wind and solar tenders in 2022 to 10GW (from 5GW)

Second, the National Energy Administration (NEA) of China issued an updated policy in which it removed any language about “subsidy reduction” and proposed for the first time a 2025 target for solar and wind: solar PV and wind will make up 16.5% of total power consumption in 2025 versus 11% in 2021. This is equivalent to a 50% share increase in 4 years, and given the growth in demand, we estimate renewables growth will be around 77% growth over 4 years.

The net effect of these large but significant policy target updates is to help meaningfully support local regulation developments, allowing more renewable and clean electricity growth, as well as provide more clarity to private industry of their need to procure these types of resources in the years ahead.

As of 30 June 2021



Due to rounding, totals may not equal 100%.

## Impact

The strategy continues to deliver a substantial positive decarbonisation impact. Based on our proprietary carbon emission database and company-by-company assessment, on an annualized basis as of 30 June, the strategy generated 180 tons of CO<sub>2</sub> per \$1 million invested compared to 723 tons of CO<sub>2</sub> per \$1 million invested in the MSCI World Utilities Index, a reduction of 75% for our investors. This CO<sub>2</sub> reduction is equivalent to 493 return flights from New York to Los Angeles in economy class per \$1 million investment.

Top 5 Contributors in Q2 2021	Bottom 5 contributors in Q2 2021
Covanta	Enel Chile SA
China Suntien Green Energy	Scatec Solar ASA
China Longyuan Power	Orsted A/S
Renova Inc.	Brookfield Renewable Partner
NextEra Energy Partners	Iberdrola SA

### Top 5 Contributors

**Covanta** is a U.S. leader in waste-to-energy with exciting development plans in the UK. The company reported very strong 1Q2021 results and increased its 2021 guidance on the back of strong waste volumes and strong prices for recycled metals. Moreover, it introduced a cost-cutting plan, 2025 targets and details on the expected contribution from its UK assets under construction, thereby providing visibility on the ramp up in EBITDA and cash flows. While some of these factors relate to an improving economic cycle, we believe further value enhancing activities and/or some crystallisation of value will be announced in the coming months.

**China Suntien Green Energy** is a Chinese power generation company with all its generation coming from renewables. We find the regulated and contracted growth prospects, valuation and yield very attractive.

**China Longyuan Power** is a Chinese power generation company with the majority of its generation coming from renewables, was again a strong contributor in the quarter. The stock continued its positive momentum after concerns relating to new renewable project auctions and subsidy payments subsided after the Chinese government released a final version of the policy which was more benign to developers than originally feared. Progress towards an A-share listing and assets swaps with its parent appears on track and should prove a further positive catalyst for the stock later this year.

**Renova** is a pure renewables electricity generation company with assets in Japan and Vietnam. Renova has benefited from the growing momentum for renewables in Japan and anticipation around the upcoming closing of the first Japanese offshore wind auction for which Renova is a strong contender.

**NextEra Energy Partners** (NEP) is the dedicated renewables listed entity of NextEra Energy. NEP benefited from the extension of its growth prospects further in the future as well as an attractive relative valuation.

### Bottom 5 contributors

**Enel Chile** is the leading utilities in Chile. The stock suffered from rising political uncertainty in the country, but even if the political calendar is heavy over the next 12 months, we see tremendous growth and valuation upside over the medium term while collecting a 7% dividend yield.

**Scatec** is a pure renewables developer and operator in emerging and frontier markets. Its shares struggled on the back of the announcement that a Ukrainian electricity offtaker is requiring small amendments to some PPA contracts and delaying payment in the meantime, which is triggering a default on the non-recourse debt. Issues with offtakers in emerging and frontier markets are somewhat expected over time but this was clearly unnerving investors. Subsequently, Scatec announced large contracts in India and South Africa although the stock hasn't responded yet.

**Orsted**, the global leader in offshore wind, had to take a provision due to construction defects on some offshore plants. This is one-off in nature and not altering the fundamental thesis but reinforcing the negative sentiment.

**Brookfield Renewable** is a Canadian renewable developer and operator with global operations. It sold some assets to Orsted and NextEra Energy Partners and seems to be building a war chest to fund its growth or M&A but the market didn't reward the stock for that move.

**Iberdrola**, a global leader in the energy transition, was affected by the headwinds of the sector as well as potential criminal charges brought against the CEO. Given the ESG risk, we have exited the position for now.

## Looking ahead

Over the coming months, we are looking forward to several policy drivers: the EU Commission will issue a revised Emission Trading Scheme Directive later in July to reflect the EU's 55% by 2030 emissions reduction targets (which could make products using O&G energy in their manufacturing process more expensive), the U.S. infrastructure bill should pass at some point in 2H 2021 (which is likely to include various tax credits and incentives for renewables, battery storage and transmission) and then the UK hosts COP26 in November.

A portion of the portfolio is exposed to renewables developers which, having underperformed YTD, have an opportunity to regain the confidence of investors if they can demonstrate pricing power by increasing the prices of power purchase agreements for new projects in order to pass on the higher commodity costs they face near term. This would demonstrate a discipline in sticking to attractive returns in a market that has attractive structural growth characteristics.

In terms of risks, we continue to monitor inflation trends, interest rates and the yield curves as well as regulatory developments, especially in Spain and the U.S.

## Disclaimers

This commentary contains certain forward-looking statements. These forward-looking statements include all statements regarding the intent, belief or current expectations regarding matters covered and all statements which are not statements of historical fact. The forward-looking statements involve known and unknown risk, uncertainties, contingencies and other factors, many of which are beyond our control. Since these factors can cause results, performance and achievements to differ materially from those discussed in the presentation, you are cautioned not to place undue reliance on the forward-looking statements.

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\*\*The Ecofin Renewable Infrastructure Unrestricted Composite (the "Composite") is a composite representing the strategy as traded in pooled funds and to be traded in standalone managed accounts, excluding the standalone managed account which comprises part of a UCITS pooled fund. The Composite creation date is 10 January 2019 and the inception date is 30 November 2015. Net performance is calculated using actual net performances for the standalone funds. Ecofin claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Ecofin has been independently verified for the periods 1 January 2013 – 31 December 2019. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report. A complete list of composite descriptions and GIPS® composite reports is available upon request by contacting Client Relations at [ClientRelations@tortoiseecofin.com](mailto:ClientRelations@tortoiseecofin.com).

**All investing involves risk. Principal loss is possible. The risks of investing vary depending on an investor's particular situation.**

**Past performance is no guarantee of future results. Returns may increase or decrease due to currency fluctuations.**

Index Information:

The S&P Global Infrastructure Index The S&P Global Infrastructure Index is designed to track 75 companies from around the world chosen to represent the listed infrastructure industry while maintaining liquidity and tradability. To create diversified exposure, the index includes three distinct infrastructure clusters: energy, transportation, and utilities. The S&P Global Clean Energy Index is designed to measure the performance of companies in global clean energy-related businesses from both developed and emerging markets, with a target constituent count of 100.