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Energy transition: time to consolidate

Higher interest rates demand a shift in focus from innovation to performance optimization, says Raphaël Lance

Energy transition has accelerated beyond expectation in the last five years, with private investment into renewable projects leading the charge. But can the pace of this investment be sustained amid rising inflation, soaring interest rates, and an accompanying retrenchment of risk?

We believe this is a time to consolidate and for investors to optimize their offerings. For us, that means consolidating our innovation of the last few years and reaping the benefits, without overextending ourselves. In fact, higher inflation and interest rates may even spur improved performance for investors with experience in the energy transition sector.

An intense period of innovation

Mirova is an early energy transition pioneer. From its €50mn investment in French wind farms in 2002, we have now funded more than €3.5bn in global energy transition projects. Today, Mirova's portfolios feature key technologies such as energy storage, biogas, hydro power, hydrogen, and electric mobility.[1]

Along the way, our focus has shifted from building facilities supplying energy directly to the grid, to B2B projects such as energy storage and installation infrastructure for electric vehicles.

Our geographic focus has also changed. Within Europe, Mirova's core Western Europe remit now includes Eastern Europe and the Nordic countries.[2] Meanwhile, a major expansion in Africa gave us greater exposure to agrisolar, e-mobility, solar home system, and commercial and industrial (C&I) solar. We have also expanded organically in APAC, with the addition to our Singapore team of eight local investment professionals. We believe that having fully-staffed teams on the ground is vital for fostering relationships with developers and gaining access to deals.

Time to double down

After this period of intense innovation and development, the prevailing economic and financial climate means it is now time to consolidate. We will use Mirova's experience of the last two years to bed in all the innovation and focus on optimizing performance.

Raphaël Lance
Managing Director and Head of Energy Transition Infrastructure Funds,
Mirova - the affiliate of Natixis IM dedicated to sustainable investing

Mirova now has $32.6bn AUM across its portfolios, with $3.2bn in energy transition.[3] Our recent impact report shows we have financed more than 1,000 projects in 48 countries and funded 6.8GW of renewable energy installations.[4] As a result, more than 660,000 people have new or improved energy access.

With higher interest rates and more business uncertainty, Mirova is doubling down on its approach. As such, we will continue to focus on investing in small developers of projects which they then sell to the big utilities that have distribution muscle and want to grow their asset bases.

The knowledge and experience in its teams allow Mirova to not only withstand the more challenging macro environment, but to exploit it. For instance, it structures deals for the long-term, locking in today's high energy prices for 10–15 years and providing a hedge to any future softening of the energy markets.

What's more, higher inflation may reduce returns from some assets, but for energy transition projects, it could mean mean higher profits. Mirova's exit multiples have risen significantly as a result of improved profitability.

Diversification through private equity

More expensive financing provides an opportunity for investors to buy directly into development companies, as well as finance individual projects.[5] Many fast-growing development companies are finding it harder to self-fund or obtain funding from traditional sources, and are willing to trade equity for a capital injection. To meet this need, we

1 https://www.im.natixis.com/en-institutional/news/driveco-raises-250-million-to-become-one-of-the-european-leaders-in-electric-vehicle-charging-infrastructure

2 https://www.im.natixis.com/en-institutional/news/tagenergy-welcomes-two-new-major-investors-mirova-and-omnes-to-support-its-global-project-pipeline-and-speed-energy-transition

3 Source: Mirova as of 30 June 2023.

4 https://www.im.natixis.com/en-institutional/insights/mirova-energy-transition-infrastructure

5 https://www.im.natixis.com/en-institutional/news/girasole-energies-a-new-independent-player-in-photovoltaic-solar-energy-production-raises-96-million-from-mirova

have added a private equity element to our portfolios, which is now accounting for almost half of our allocations and becoming a strong additional driver of performance.

Development companies are typically independent power producers which launch and operate renewable energy projects. In the past, these companies have typically sold maturing projects to larger utilities or derived fees from their projects to fund themselves. But with debt more expensive to obtain, they are looking for alternative sources.

The increasing maturity of the energy transition infrastructure sector and our long track record mean we are prepared to accept the additional risk and return provided by private equity deals. With IRRs from regular infrastructure projects currently at around 4%–5%, direct investments in development companies could provide significant uplift.

Deal flow momentum

Competition for individual projects is increasing as the energy transition sector matures, but the pool of projects is deepening too.

There is currently a lot of fundraising and newcomers. Fortunately, there is also great financial need, with hundreds of billions needed for energy transition, mobility transition, the decarbonization of industry, and an accompanying focus on emerging hydrogen projects.

In addition, while high interest rates reduce liquidity overall, energy transition has moved to the top of investors' agendas.

The global political consensus around energy transition also favors continued investment. The European Union aims to reduce net greenhouse gas emissions by 55% from 1990's levels by 2030 and ensure that 42.5% of its total energy use is via renewables.[6]

Asia is moving in the same direction, with China leading in the construction of wind and solar facilities. Meanwhile, in the US, 14 states – plus Puerto Rico and the District of Columbia – have 100% clean or renewable energy targets.

Potential for risk-adjusted outperformance

For experienced investors who understand the risks, the returns on offer from energy transition should comfortably outperform those of traditional assets on a risk-adjusted basis. In the last few years, Mirova has targeted 8%–9% IRR, but this has now risen alongside higher power prices. Performance could be further boosted by the private equity component. It's more volatile, but successful investments can return 5x the money, and overall, IRRs in our portfolios have improved. Of course, we've been doing this for over 20 years, and this is the time for experienced professionals – not a job for debutants in the current environment.

6 https://climate.ec.europa.eu/eu-action/climate-strategies-targets/2030-climate-energy-framework_en#:~:text=In%20July%202021%2C%20the%20European,climate%2Dneutral%20continent%20by%202050

Raphaël Lance joined **Mirova** in 2009 as Director of Energy Transition Infrastructure expertise. Since then, he has successfully led the team and launched several funds, allowing Mirova to become a leader in the energy transition space, with €3.5bn AUM. He is also leading the energy transition infrastructure emerging market team following the acquisition of SunFunder in 2022.

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