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HOW CUTTING-EDGE ENERGY INFRASTRUCTURE IS DELIVERING OLD FASHIONED RETURNS

By Ivor Frischknecht, Managing Partner, CIO Asia-Pacific at Sosteneo Infrastructure Partners

The scale of change underway in energy infrastructure is enormous. But with a traditional approach and detailed understanding of the changing market, it is possible to deliver the kind of stable and predictable returns that investors have come to expect from an infrastructure allocation, says Ivor Frischknecht, Managing Partner, CIO Asia-Pacific at Sosteneo Infrastructure Partners, part of Generali Investments.

- Solar, wind and battery energy storage projects represent excellent traditional infrastructure assets because almost all the risk is in development, with much of the cost fixed at the time of construction.
- To date, Sosteneo has focused on investing in new clean energy generation, entering offtake agreements to secure long-term contracted revenues for our clients.
- We are also investing in large-scale battery energy storage systems, leveraging more than a decade of experience financing the rapidly growing technology.

Like solar, battery storage is competing with traditional energy infrastructure

There's little old fashioned about the renewable energy projects transforming the world's energy infrastructure. However, as cutting-edge technologies reshape the way we generate and consume energy, these projects can perform the role of traditional infrastructure to provide stable, predictable returns in a diversified portfolio.

Eight years ago, while in my role as the inaugural CEO of the Australian Government's renewable energy agency, ARENA, we saw an opportunity. Australia enjoyed lots of sunshine, a vast landmass, and a successful wind industry. Despite this, large-scale solar was struggling to establish itself in the market due to the high cost in an immature sector.

Through ARENA's role investing in renewable energy to make it more competitive, we allocated $92 million to 12 solar farms, attracting an additional $1 billion in private backing. These projects helped to halve the cost of large-scale solar and provided a launchpad for the technology to compete with fossil-fuelled incumbent technologies.

The rapidly growing large-scale solar industry, combined with world-leading uptake of residential rooftop solar, created another new opportunity: to store abundant, affordable daytime power in the largest batteries the world has ever seen.

Like solar, the first battery projects needed government investment to get off the ground. However, by late-2017 they showed their potential to store wind and solar power whenever needed and compete with traditional energy infrastructure. There are now 20 large battery energy storage systems operating across Australia, with another 38 under construction.

These two examples demonstrate the rapid transformation taking place in the way we develop infrastructure.

The ongoing appeal of infrastructure as an asset class

Infrastructure has grown significantly over the past two decades to become a vital component of institutional portfolios, crossing the $1 trillion threshold for the first time in 2023[1]. The appeal of renewable infrastructure is evident as decarbonisation efforts intensify.

The 2024 Infrastructure Investor LP survey shows renewables are the top priority, with more than 82 per cent of respondents nominating that they will invest the same or more capital in this sector over the next 12 months. At the same time, investors are indicating the strongest interest in the core-plus risk profile, suggesting a move up the risk curve as core and super-core fall out of favour (Figure 1).

On a regional basis, Europe has been embracing renewable energy to improve energy security and reduce its reliance on imported fossil fuels from Russia.

> The appeal of renewable infrastructure is evident as decarbonisation efforts intensify ”

For Germany, Spain, the UK, and others that rely on energy imports, the transition to renewable energy offers opportunities to improve energy independence. Solar, wind, battery storage and electrification provide a pathway to reduce reliance on Russia and increasingly unstable supply chains.

sosteneo
Infrastructure Partners

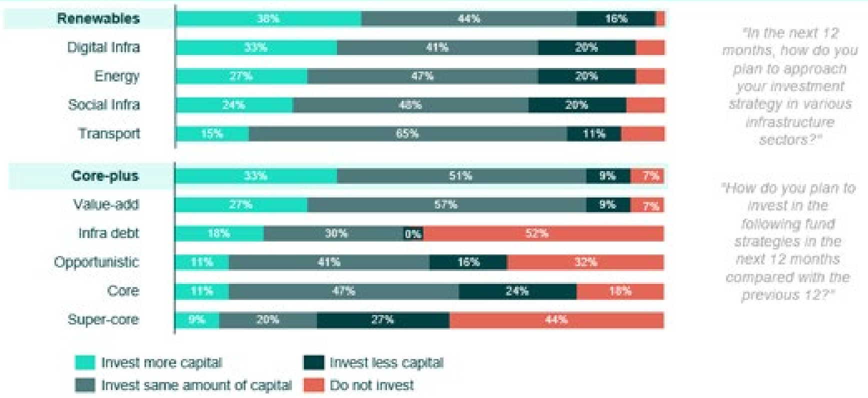
Sosteneo is an asset management company that specialises in greenfield infrastructure investments that produce clean energy or enable clean energy use.

They were established in 2022 by four founding partners alongside Generali Investments. Together, they are motivated by a common goal: to deliver an attractive long-term commercial return to their clients through the structuring, building, optimising, and monetising of energy infrastructure projects that make an active contribution to the decarbonisation of the global energy system.

[1] Source: Infrastructure Investor, November 2023

CORE PLUS RENEWABLES ARE A TOP PRIORITY

Institutional investor survey responses (infrastructure)[1]



But despite the ongoing appeal of renewable infrastructure, as the asset class has grown we have begun to witness a shift with significant implications for investors.

Victim of its own success?[2]

With the potential to provide attractive returns that are less correlated with other investments, renewable energy projects can perform the same role in an institutional portfolio that other types of infrastructure have done for decades. In fact, solar, wind and battery energy storage projects represent excellent traditional infrastructure assets because almost all the risk is in development, with much of the cost fixed at the time of construction. There is also no exposure to fuel prices and maintenance costs are low and predictable.

While renewables represent a particularly strong infrastructure investment opportunity, there are other shifts taking place beyond the technologies being deployed.

As the asset class has come of age, infrastructure funds have grown ever larger in size, including in the renewables space. The need to deploy significant amounts of capital efficiently has resulted in a 'style drift' away from investments in individual projects towards large private equity-like investments in corporate development vehicles.

This approach undoubtedly offers the potential for attractive returns. But by investing in corporates rather than projects, such returns rely almost entirely on exits. This is quite a divergence from the stable, predictable cash flows on which the infrastructure asset class has built its brand – and how the asset class earned its place in the strategic asset allocations of investors.

Bringing a traditional perspective to transformative technologies

At Sosteneo, we believe in a traditional approach to infrastructure. We invest in projects and secure long-term contracts to provide regular income. As greenfield specialists, we invest just prior to construction, avoiding development risk but retaining the opportunity to leverage our expertise and active management to unlock capital growth.

We believe this hands-on approach, underpinned by stable cash flows, reflects the intended role for infrastructure in institutional portfolios and offers the best way to meet the expectations of our clients.

> As greenfield specialists, we invest just prior to construction

By building tangible energy generation and storage assets, our projects deliver infrastructure to meet a growing need in a way that clearly addresses climate change. They are also resilient, supplying an essential service that withstands business cycles over an operating life of more than 20 years.

This approach provides steady returns with low ongoing costs, facilitated by free fuel from the sun and wind.

How our infrastructure investments deliver real infrastructure returns

The world is installing renewable energy at speed, but the transition is still in its early stages. As markets evolve to value the energy and services clean infrastructure provides, new revenue streams are emerging.

To date, Sosteneo has focused on investing in new clean energy generation, entering offtake agreements to secure long-term contracted revenues for our clients.

We are also investing in large-scale battery energy storage systems, leveraging more than a decade of experience financing the rapidly growing technology.

These batteries provide stable revenue through long-term inflation-linked contracts, achieved in partnership with energy traders and government-led market and transmission operators. This provides a valuable win-win: our partners secure their energy costs at a fixed price, while we receive a steady stream of predictable cash flows for our clients.

> The world is installing renewable energy at speed, but the transition is still in its early stages

To meet the growing need for energy storage, Sosteneo acquired the Koorangie Energy Storage System (KESS) project in 2023. Located in a remote part of south-east Australia, the facility is designed to soak up energy from nearby solar farms to deploy when the grid needs more power to remain in balance.

KESS is one of a growing fleet of big batteries performing this service across the grid covering Australia's eastern states, using their immediate response time and low energy input costs to challenge incumbent gas generators.

KESS has a 15-year capacity agreement with Shell Energy and a 20-year system strength agreement with the Australian Energy Market Operator; both of which are linked to the consumer price index.

As a hands-on equity investor, this project provides a snapshot of our approach to renewable infrastructure. Investing in the battery system prior to construction provides a strong platform to unlock capital growth potential, and subsequently navigating the asset through initial operations provides further opportunity for value enhancement. After these phases, with the long-term contracts generating a healthy and predictable yield, we can present to market a de-risked asset with proven track record – a simple and compelling opportunity for a brownfield investor.

[2]Past performance does not predict future returns. There is no guarantee that an investment objective will be achieved or that a return on capital will be obtained. The product does not benefit from any guarantee to protect the capital.

Accessing the opportunity

Energy infrastructure is full of opportunity. Projects and technologies may look different to the past, but the role in a portfolio can remain true to the original thesis of infrastructure investing.

Yes, the scale of change underway is enormous. However, Sosteneo is proving that with a traditional approach and detailed understanding of the changing market, it is possible to deliver the kind of stable and predictable returns that investors have come to expect from an infrastructure allocation.

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Investment objective and policy: The objective is to realise attractive risk-adjusted returns, providing capital growth and income, by investing primarily in equity infrastructure investments as the Investment Manager will determine in accordance with the requirements of the RAIF Law. The aims is to build a portfolio that is well diversified across various characteristics including risk profiles, countries and sectors. The target* is a portfolio level internal rate of return (IRR) in EUR terms of 9% to 11% on drawn capital over the Fund's life, net of Management Fees, Carried Interest Distributions, and Expenses, and before tax. The product is actively managed without reference to a Benchmark.

*This is an internal expected target return and not a promise on performance. This target return is not guaranteed and is not an accurate indicator of future performance. There is no guarantee that an investment objective will be achieved or that a return on capital will be obtained. The Sub-fund does not benefit from any guarantee to protect the capital.

Risk factors of the Sub-fund (non-exhaustive list): Acquisition of debt; Investment in small to medium-sized entities; Fixed-income instruments; Lender liability risk; Liquidity in the market for loans; Risks associated with private debt securities; Private debt terms; Unregistered securities; Market developments; Risk of capital loss: this is not a guaranteed product. Investors may risk losing part or all of their initial investment.

This is not an exhaustive list of risks. Other risks and costs apply and are subject to change. All the risks, maximum costs and their calculation frequency are detailed in the Issuing Document, available upon request to the AIFM. Before making any investment decision, please read the Issuing Document, in particular the costs and risks sections.