Chanticleer

For crowing there was not his equal in all the land...

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Nine ways to profit from energy mess

Lost among the drama of the far right's gains in the European parliamentary elections was the fascinating story of the losses sustained by greens parties.

In France, the Greens polled just 5.5 per cent, down from 13.5 per cent in 2019, while in Germany, the Greens' vote dropped from 20.5 per cent to 11.9 per cent. While the Greens' vote did rise in The Netherlands and Spain, the consensus is that they were among the biggest losers from the elections.

Why did this occur? Societe Generale strategist Albert Edwards believes it may be a reaction to so-called "greenflation".

"Europe has been among the most aggressive adopters of measures to push consumers away from oil and gas. The resulting jump in costs [not to mention the ever more urgent deadlines for climate change targets] has put unprecedented extra pressure on consumers already in the midst of a full-blown cost-of-living crisis," he says.

Opposition Leader Peter Dutton may be banking on a similar shift in Australia. The announcement that a Coalition government would back away from Australia's Paris Agreement commitments looked politically risky, and would certainly increase sovereign risk for a business community that desperately wants settled policy around decarbonisation. But perhaps Dutton senses the trends from Europe will be repeated here.

The pushback against greenflation is unlikely to be good news for developers of renewable Europe, who were already struggling to make a buck.

Local analysts from Citi said their takeaway from conversations with Danish wind giant Orsted, a major competitor to Macquarie Group, was that renewable projects had been "materially challenged" by surging construction costs, rising inflation and government pressures on electricity prices.

"Asset prices have been falling, reflecting higher rates and insufficient government support for the current market reality," Citi surmised.

With support for the Greens sliding further in Europe, the renewables sector may not get the increase in government support it wants any time soon. Which raises an obvious question: where exactly is the money going to be made from the energy transition.

To tackle this, we turned to Shehriyar Antia, head of thematic investing at the $2.02 trillion investment manager PGIM, who recently completed an in-depth look at the investment opportunities for investors.

Antia, who is based in New York, says this is complex territory to navigate, in large part because it is a sector where "two seemingly contradictory things can both be true at the same time".

On one hand, global renewable power capacity increased by 50 per cent last year and will triple by 2030. "But it's also true that more than 80 per cent of our energy today comes from fossil fuels, and fossil fuels will not be easily displaced. They have a tremendous incumbency advantage, and they are very likely to be with us for a number of decades."

Antia recommends an approach similar to stock-picking, where knowing what parts of the sector to dodge is as important as knowing where to play.

Investors will need to not only decide what parts of the energy sector they go into, but what geographical regions and what parts of the capital stack.

For example, PGIM sees opportunities to invest in renewable power generation, but its preference is for debt over equity; the former is much less plentiful in Europe and the US. But not all renewable generation projects are equal in the current environment; Antia says geothermal and hydro projects offer better opportunities than wind and solar.

PGIM points to five other green energy opportunities:

■ India's renewable generation sector enjoys a strong tailwind from broader economic growth, but companies with a strong track record of turning projects into cash flow are preferred.

■ Wind projects are out of favour, but wind turbine manufacturers provide exposure to wind without exposure to project risk or electricity price volatility.

■ Manufacturers of components for modernising and expanding electricity grids should see strong demand. In an example of how granular investors need to get, PGIM sees a particular opportunity in South American transmission companies that have the ability to pass through costs to end users. "We need more transmission lines, the grids that we have need to be hardened," Antia says. "This is literally a universal opportunity."

■ Long storage (generally seen as anything over four hours) is a global opportunity, and Antia says pumped hydro projects are particularly attractive. Spanish giant Iberdrola has several pumped hydro projects in Europe, and is looking to expand.

■ Vertically integrated energy companies that cover energy generation and distribution could be well-placed to navigate the transition, creating interesting opportunities for debt and equity investors.

But given PGIM's view that fossil fuels are here to stay, it has also pinpointed three lower-carbon, fossil fuel-related plays investors should examine:

■ PGIM sees natural gas as a vital transition fuel as it increasingly displaces coal, and sees promise in smaller US gas producers, large LNG players, and the debt of pipeline companies.

■ The dearth of bank debt for mid-sized energy producers has created opportunities for private capital in this sector. Antia suggests looking beyond explorers for companies in production that have both cash flow and collateral.

■ Big oil companies, while clearly facing a level of obsolescence risk, can abate this by leaning into lower-carbon energy sources. PGIM also notes these groups are also among the leaders in patents in areas such as biofuels and carbon capture.

PGIM's assessment of the energy landscape reminded Chanticleer of the message this week from Origin Energy, which used its investor day to effectively argue it could play all the parts of the transition: strong earnings from its last remaining coal-fired power plant (for a couple more years at least); strong earnings from its market-leading fleet of gas peaking plants that will be increasingly needed to firm up renewables; and strong earnings from storage and capacity infrastructure. And for now at least, it sees question marks over the economics of renewable generation.

Just as important as where to invest in energy is what to avoid. PGIM is not sold on many of the hottest technologies in the sector: small nuclear reactors (which it says are largely uneconomical and plagued by delays); nuclear fusion (hard to replicate outside a lab); grid-level power storage (challenges around energy density, cost and efficiency); and, perhaps most notably for Australia, hydrogen and carbon capture and storage.

"They all offer tremendous game-changing potential that can really accelerate the energy transition. But it's also true that they're all immensely challenged in the near term, and for investors, they may not offer very good risk/reward propositions today," Antia says of the latter technologies.

He argues that as occurred in solar panel manufacturing and lithium batteries, these sectors may need government funding to get off the ground.

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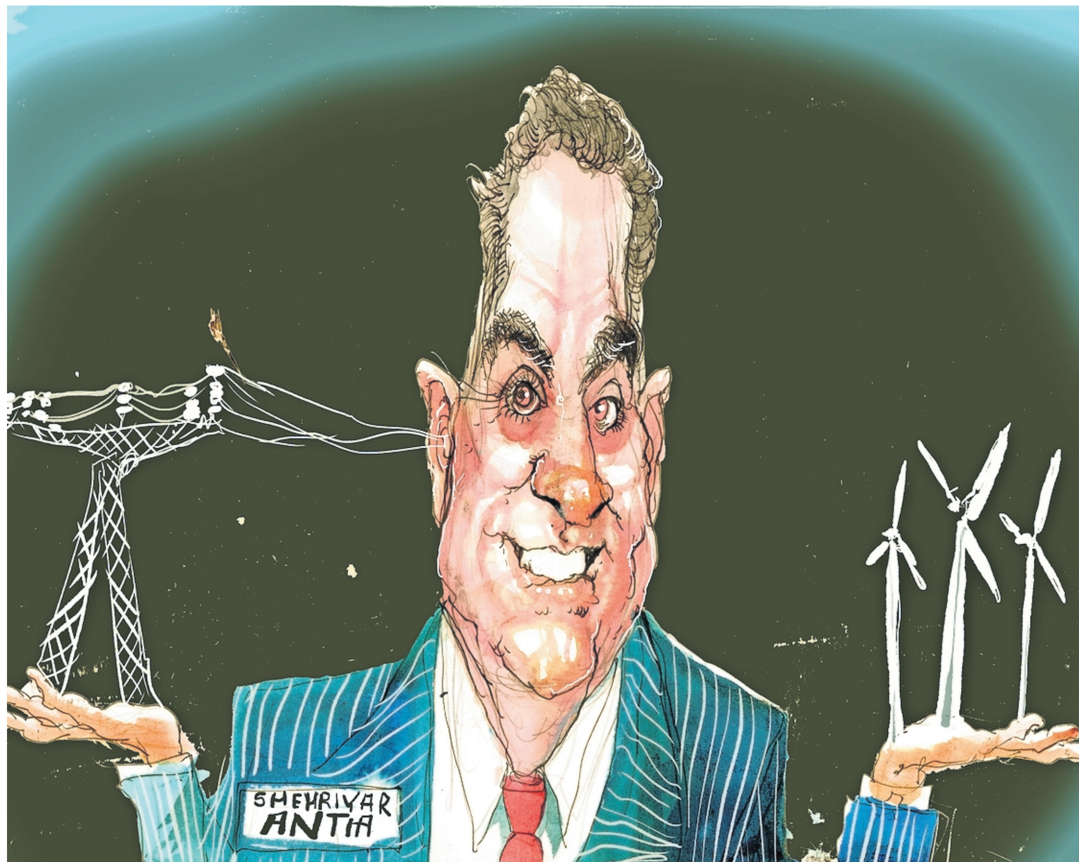

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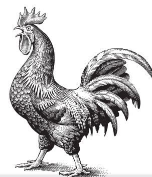
Celebrating five decades of crowing



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Xi Jinping is hardening [China] to close off any weaknesses in readiness for potential conflict over Taiwan ... and to forestall US leverage of any kind.

Global perspective **p38**

Even Coalition colleagues are a bit perplexed about where Dutton's political strategy is supposed to be going on nuclear policy, and now emissions targets.

The nation **p39**

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