Renewable Boards Must Power Up

An open letter to the boards of, and our fellow shareholders in, investment trusts in the renewable energy sector

The listed renewable energy sector has been a notable British success story. The UK has a thriving closed end fund sector whose structure – a publicly quoted company holding a pool of investments – is ideally suited to holding illiquid assets such as wind and solar farms. From modest beginnings in 2013 the sector has grown to ~£16bn today and has been an important source of private capital to help meet the UK and Europe's decarbonisation targets.

CG Asset Management has been an investor in the sector since inception and has participated in several IPOs and even more placings, providing much primary capital to the sector. At present we have around £100m invested. Like others, we were attracted to the predictable, index linked returns. Like others, we and our investors wanted to play our part in supporting the shift away from fossil fuel reliance. Were it not for recent government intervention we would most likely have much more invested in renewables.

The sector's response to the recent energy price surge has been exemplary. Boards have elected to retain the vast majority of their unexpected profits for reinvestment in new projects, while growth in shareholder distributions has been modest. Sadly, the government's response has been much less constructive through the introduction of a capricious windfall tax. The effect has been all too predictable. Faced with regulatory uncertainty, investors have increased their required rates of return and share prices now stand at discounts to their underlying net asset values. Since no board will sanction raising capital on terms which will dilute their existing shareholders, the tap of fresh capital for listed renewables has been turned firmly off.

The government's desire to decouple the price of electricity from the wholesale gas price is in the interests of all stakeholders: consumers, investors and the tax payer. Their aim is laudable, their methods are not. What should be done instead? The government should dismantle its windfall tax as quickly as possible, replacing it with long-term contracts for difference (CFDs) like those used in the offshore wind sector. Investors would gladly trade a lower price for greater stability and lower volatility. The sector's cost of capital would decrease to everyone's benefit. Such long term CFDs or power purchase agreements would be set far below current spot electricity prices, benefitting consumers. After all, the cashflow models which drive the net asset values of renewable projects assume much lower electricity prices in the future than prevail today – £40-50 per MWh from 2030 onwards, in today's money.

For the time being, the prospect of such pragmatism is remote. The burden falls then to the boards in the sector to take urgent action. For as long as their shares trade at discounts, trusts cannot raise additional capital, and without fresh capital our path to net zero looks more challenging. To counter this, boards must aggressively buy in their company's shares until they once again stand at premia, premia which were the norm for most of the past decade. Boards will understandably be reluctant to divert cash from new projects to buying back shares. They need to be farsighted and resolute. Shrinking now will enable them to grow faster in the future. "Shrink to grow" should be their mantra. It is right for their shareholders and right for the planet.

Chris Clothier, Co-Fund Manager
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