

The investment opportunity in sun, wind and waste

By Mike Pinggera, Head of Multi-Strategy

Renewable energy is not a new concept. Our ancestors used biomass to fuel fires, wind to grind grain and pump water, and hot springs for bathing and heating space. But a rapidly growing global population – and the discovery of oil, gas and coal – led to a global reliance on fossil fuels, at the ultimate expense of these natural resources and our environment.

As the world wakes up to the long-term challenge of energy production and distribution, so opportunities arise. Here, we discuss why renewable energy investments now make up 30% of the Sanlam Real Assets Fund, and why they will continue to make a very compelling investment case.

Investment in Renewable-Energy Producers

When it comes to investing in energy, the first phase of opportunity is what we call the 'build-out' phase. Climate change and the depletion of fossil fuels have been influencing the political agenda for many years, and governments around the world have therefore been compelled to subsidise the development of renewable energy. That investment has given rise to technology that is now profitable, and therefore investable.

Wind is a great example of this. Thanks to government subsidies, the UK is now a market leader in offshore wind farms, and over the past few years, advances in wind power technology have helped to dramatically drive down production costs. For example, in 2014, contracts for offshore wind projects were won at circa £150 per megawatt-hour (MWh) – the energy required to power around 330 homes for one hour. In contrast, the lowest bid price in 2017 was £57.50 per MWh for Hornsea 2 wind farm. In effect, the cost of producing renewable-sourced energy is far lower and this has occurred without jeopardising investors' returns.

Prices will likely come down further as technology continues to improve, and efficiencies and economies of scale are found. Government subsidies are no longer needed because the business case holds up on its own, so manufacturers of this technology now have a global market to tap into, as well as a bright future.

This is not just the case for wind power. There are other similar initiatives going on for anaerobic digestion (the production of energy from waste) and solar power. Indeed, the cost of solar modules has dropped by 84% since 2010, with analysts forecasting another 52% decline by 2025 through further efficiencies in production chains. Today, it is cost competitive with fossil fuels.

Energy Optimisation

Beyond developing the technology and infrastructure to generate renewable energy, the second phase of investable opportunity is 'optimisation', or maximising energy efficiency.

Much of the demand for improved energy efficiency is driven by large global organisations who want to reduce their carbon footprint and their long-term energy costs. We're seeing the emergence of businesses that can service this need. Take, for example, the company that replaced the light bulbs across Santander's UK branch and office network. This was a huge and lucrative task but will ultimately save Santander vast sums of money over the medium to long term. It also ensures they are doing what they can for the environment, which becomes an important corporate message.

We look for businesses that are investing in new technologies to tap into the need for energy efficiency, and this includes companies that are investing in storage solutions. For example, there's a growing appetite to provide large offices and buildings with 'off-grid' energy, meaning their power is generated, stored and then distributed on-site. This energy is therefore more efficient and overcomes the cost of losing 60% of power between the grid and the office floor. Investing in companies that are at the forefront of such technology could ultimately pay huge dividends.

Demand-Side Management

The art of controlling energy demand is not yet an investable sector, but it's important we're aware of developments

in this area as it's inextricably linked to production and efficiency, and could impact on the future profitability of energy companies.

An example of this is the ability of power companies to lower energy consumption in one area in order to meet surging demand elsewhere, rather than having to supply more energy to meet that demand. So, with the right technology, they could turn down the fridges or slightly dim the lights across all major supermarkets. While this has no noticeable impact on the supermarket or their customers, it does manage the energy supply more efficiently, which will ultimately affect cost and demand.

Conclusion

Investing in energy companies is attractive because they are income producing with long contracts, and the world will always need energy in one form or another. We are particularly interested in companies that invest in the future of renewable energy and the optimisation of that energy because we believe they will have a vital role to play in meeting future global demand. According to Bloomberg New Energy Finance, renewables will account for two-thirds of the world's energy supply by 2050, compared to two-thirds fossil fuels in 2017. While that's still thirty years away, the journey is set to be both lucrative and exciting for investors. An in-depth understanding of this market is therefore crucial – something we take very seriously on behalf of our investors.

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