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The sun is still shining for NextEnergy Solar

NextEnergy Solar Fund is on the hunt for new markets. Michael Bonte-Friedheim talks to Dave Baxter

As investors face up to another challenging year, few asset classes tick so many boxes as infrastructure. Offering a high, reliable income and an element of inflation protection with seemingly low correlation to economic developments, infrastructure investment trusts remain in high demand.

Renewable energy infrastructure trusts have additional appeal, given their strong environmental, social and governance (ESG) credentials and the possibility that they could benefit from an increase in green infrastructure spending.

NextEnergy Solar Fund (NESF), as its name suggests, specialises in solar power infrastructure offerings. NextEnergy Capital Group, the trust's manager, focuses on the development, construction and ownership of solar assets.

Clean energy infrastructure funds in general have had to deal with many challenges, including the collapse of the oil price last year. Oil has a knock-on effect on power prices, so this was detrimental to investment trusts that sell energy to the market.

NextEnergy Solar Fund's board acknowledged in its results for the six months to the end of September 2020 that it has not been immune to these pressures. While 65 per cent of the trust's revenues for this period came from government subsidies, the remainder came from selling electricity. However, the trust's ability to hedge and fix power prices gave some protection.

In late November, when the half-year results were published, NextEnergy Solar Fund's board noted that it had secured fixed pricing for 87 per cent of generation for the remainder of the financial year, having also fixed 58 per cent of generation prices for summer 2021 and 42 per cent for winter 2021.

MICHAEL BONTE-FRIEDHEIM

NEXTENERGY CAPITAL'S PORTFOLIO WAS RESILIENT AMID THE BROADER ECONOMIC SHOCK OF THE PANDEMIC

1995–2000
VICE PRESIDENT, POWER & UTILITIES TEAM, INV BANKING, CREDIT SUISSE FIRST BOSTON

2000–2003
EXECUTIVE DIRECTOR, POWER & UTILITIES TEAM, GLOBAL INV BANKING, MORGAN STANLEY

2003–2006
MANAGING DIRECTOR AT GOLDMAN SACHS INTERNATIONAL

2006–2011
NON-EXECUTIVE CHAIRMAN, CHIEF EXECUTIVE OFFICER, MEDITERRANEAN OIL & GAS

2012–2013
VALIANT PETROLEUM ACTING CEO

2007–PRESENT
FOUNDING PARTNER & CHIEF EXECUTIVE OFFICER, NEXTENERGY CAPITAL

The trust's board expects a challenging and uncertain environment as far as power prices are concerned, and its shares have yet to recover from a difficult year. The trust has made a share price total return of -9 per cent over the year to 11 January.

But there were also some positive developments. Michael Bonte-Friedheim, group chief executive of NextEnergy Capital, argues that the trust's underlying portfolio proved resilient amid the broader economic shock of the pandemic, in particular because it generated more electricity than it had budgeted for, adding £6m to revenues.

"We generated 11.1 per cent more electricity than budgeted for," he says. "We have outperformed budget in terms of energy generated every year since our initial public offering (IPO). That comes from our operational skills. We have also cut costs. You get higher revenues and lower costs, which is beneficial to margins."

Mr Bonte-Friedheim argues that the trust has shown its resilience in other respects. It continued to develop solar projects in the UK even as the Covid-19 pandemic brought the economy grinding to a halt. The trust also maintained a level of 1.2 times dividend cover over the six months to the end of September 2020.

"Even in a historically one-off moment with the pandemic hitting markets, we could still generate dividend cover," he says.

Where NextEnergy Solar is headed

NextEnergy Solar remains an attractive income play, with its shares recently trading on a dividend yield of 6.5 per cent. Mr Bonte-Friedheim argues that this should allay some concerns about the shares recently trading on a double-digit premium to net asset value (NAV), despite a difficult year.

"This sector, differently to other sectors, is more driven by dividend yields than premiums," he explains. "If we were on a zero premium we would offer a dividend of about 7.1 per cent. That would be a fantastically high dividend in a zero [interest] rate environment. It [the premium] is more driven by our ability to pay those dividends."

While the payout looks both high and steady, NextEnergy Solar is joining some other infrastructure trusts in no longer linking its dividend increases to inflation. From April 2021, the dividend will instead tend to rise each year if the board considers it appropriate, based on factors including projected future power prices, the cost of hedging, inflation, dividend cover and the portfolio's operational performance.

This in part reflects the trajectory of power prices, which have been declining for several years. Mr Bonte-Friedheim notes that the power price was roughly 100 per cent higher at the time of the trust's 2014 IPO than it was in late 2020. However, he thinks that the continued dividend payments from NextEnergy Solar Fund and its peers "show the resilience of this sector rather than the risk".

New horizons

As well as a more "prudent" dividend approach, the trust's managers are looking to develop solar projects that do not receive government subsidies, in part because subsidy-backed projects are expensive to acquire.

"The financial returns are much more attractive [from non-subsidised assets] than solar assets in the UK that have subsidies," explains Mr Bonte-Friedheim. "Some buyers are willing to pay any price for these assets, but we are not. We bid on solar assets coming to market but don't win any because others are willing to accept lower returns."

Power price fluctuations aside, these assets are helped by cost reductions which, according to the trust's board, have now made non-subsidised solar assets economically competitive versus fossil fuels.

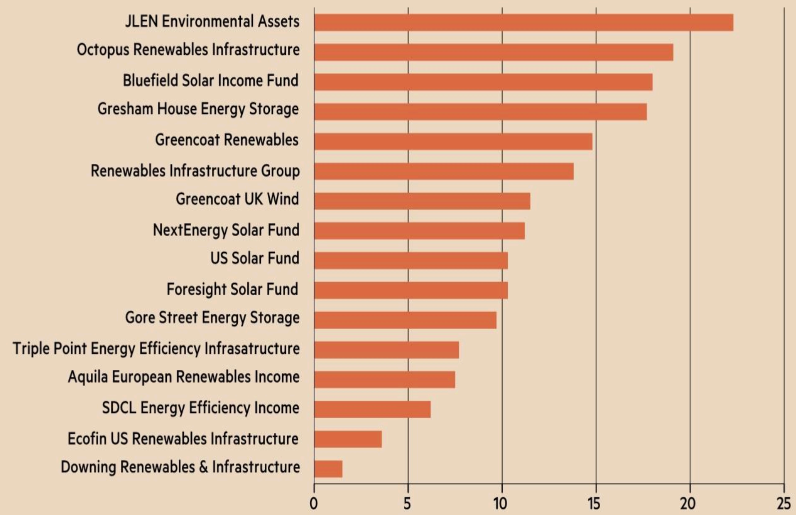
Like some other infrastructure investment trusts, NextEnergy Solar is looking overseas after receiving shareholder approval to invest up to 30 per cent of its assets outside the UK. In late 2020, it had 91 assets, 83 of which were in the UK and eight in Italy. While some have attributed an increasingly international focus by infrastructure trusts to high valuations in the UK, Mr Bonte-Friedheim believes that investor demand has also played a role.

"When we started we were all focused on the UK, but that was mainly driven by the fact that investors did not know renewable energy, were uncertain on the sector and had

THE BOARD EXPECTS A CHALLENGING ENVIRONMENT AS FAR AS POWER PRICES ARE CONCERNED

NEXTENERGY AND OTHER RENEWABLE ENERGY TRUSTS TRADE ON BIG PREMIUMS

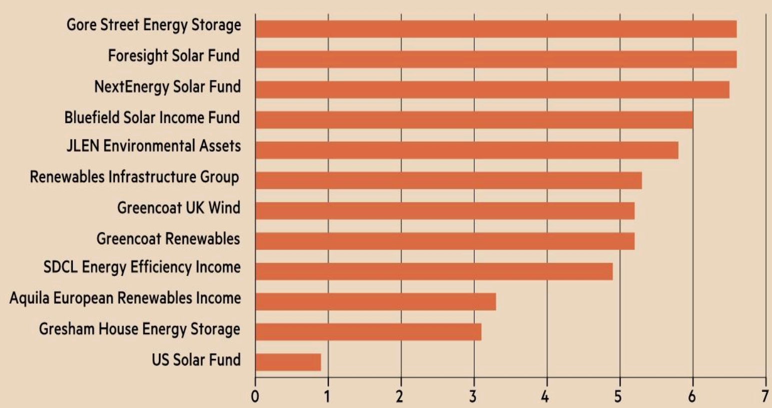
Premium to NAV (%) 11/01/21



Source: Winterflood

YIELDS OF RENEWABLE ENERGY INFRASTRUCTURE TRUSTS (%)

Some trusts which have not yet generated an income, including newer names, are not included



Source: Winterflood, as at 11 January 2021

a mistrust of sectors outside the UK," he says. "As it has progressed, investors are more familiar with renewable energy. They have encouraged the investment trusts to expand their remits. It wasn't so much being forced to look outside the UK, but more push and pull."

International exposure has advantages. Some overseas markets have a greater proportion of fixed revenues, meaning less vulnerability to the ups and downs of power prices. Investing overseas more generally diversifies a portfolio away from shifts in the UK power price, although can introduce currency fluctuations.

87%

NEXTENERGY SOLAR FUND'S BOARD NOTED THAT IT HAD SECURED FIXED PRICING FOR 87 PER CENT OF GENERATION FOR THE REMAINDER OF THE FINANCIAL YEAR

NextEnergy Solar Fund's managers are now seeking projects in the US, Portugal and Italy. More generally, Mr Bonte-Friedheim expects some positive effects from the green infrastructure spending spree that appears to be emerging around the world, although the exact benefits remain unclear.

"We would think that it would be beneficial to us," he says. "How exactly that would play out we don't know but we expect a heightened focus [on green assets]."