

KEYNOTE INTERVIEW

The art of transition



*The sustainability agenda is creating myriad opportunities for traditional, diversified infrastructure strategies, say Infracapital co-founders **Ed Clarke** and **Martin Lennon***

Q The energy transition is creating significant greenfield infrastructure opportunities. But what kind of opportunities is a global focus on sustainability creating for your diversified, brownfield strategy?

Martin Lennon: With our diversified, brownfield strategy, we target businesses with more of an operational track record than we would with our greenfield funds. But the energy transition and sustainability are front and centre throughout those portfolios, nonetheless. For example, we own a business in the Netherlands called Eteck, which provides sustainable heating and cooling systems. The Netherlands took the decision some time ago that it didn't want to increase exposure to gas, and

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so alternative solutions have had to be developed. Eteck has an important role to play there, and our role is to help an already operating business grow to meet that opportunity.

Another example is Recharge, one of the largest EV charging businesses in the Nordics, a region leading the way on transitioning from internal combustion engine vehicles to electric vehicles. We partnered with Nordic energy company Fortum to develop that business in response to evolving market dynamics. When it comes to sustainability, the distinction between greenfield and brownfield is often much less clearly defined than you might think.

Ed Clarke: Remember that all of these existing infrastructure businesses are trying to make the transition as well. You can't escape the fact that this revolution is taking place. Every aspect of infrastructure is going through change and every business in our portfolio is investing in a sustainable future.

Q Are there existing brownfield investments within your portfolio that are benefiting from an enhanced focus on transition?

EC: GB Railfreight is a great example. There's an acknowledgement today that a freight train takes an average of around 60 lorries off the road, saving around 75 percent of the CO2 emissions per TEU moved. So it makes sense for the big supermarkets, for

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example, to try to use rail to shift their produce from the ports to distribution centres.

However, we're also looking closely at how we can improve the energy efficiency of the rolling stock, specifically low-carbon locomotive technologies. Large sections of the rail network are not yet electrified, so investment has been earmarked for new solutions to ensure we're not only taking lorries off the road, but that we're also reducing the carbon footprint of the company itself.

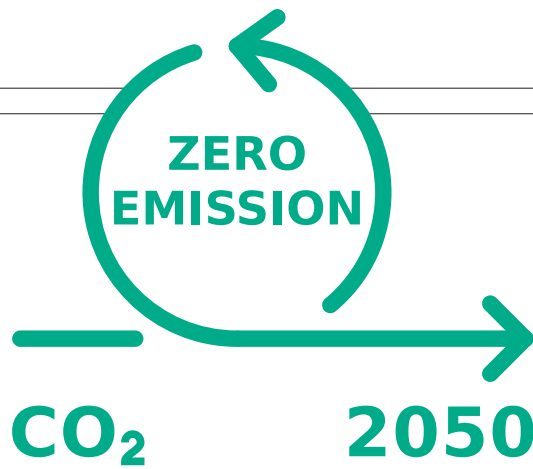
Q What opportunities are you seeing on the greenfield side?

EC: We see a whole range of opportunities. A great example in our portfolio is the battery business Zenobe. With the rise of intermittent renewables, networks are having to build the capacity to deal with sudden variances in supply. Zenobe develops large-scale battery parks at strategic locations around the UK's national grid to provide that support.

The other side of the business is focused on solutions for EV buses. It offers a holistic package to bus companies and local authorities, bringing charging to the depots, as well as the buses themselves and the software required to manage those buses efficiently. Every day, people are dreaming up new applications for batteries and we're really excited to see how Zenobe can help make those ideas a reality.

Q Given that the energy transition is such a dominant trend, why have you not decided to launch a dedicated energy transition strategy?

ML: Diversification – by geography and, importantly, by sector – is a key tool in how we manage our portfolios. Having said that, so much of what we do is either directly or indirectly linked to the energy transition, so you could say our strategy is, in fact, energy transition-focused to a large extent, just



Q What role should government play in driving investment into the energy transition?

EC: Over the past two years, governments have embraced the transition to net-zero carbon by 2050. What we are now gradually seeing is the introduction of more detailed policy and a roadmap of the intermediate stages that need to be reached. That's important. What we need from government is a clear sense of the direction of travel. We need to be sure that we are in line with the way governments want the world to move when we invest.

The good news is that it isn't just the ruling parties that are behind the energy transition. Opposition parties also support the trend. We can be confident that, even with political change, the general momentum will be maintained. But what we need now is more granular detail and support.

There have been some great examples of how that can work, the most well-known being the use of contracts for difference in offshore wind. There was a lot of scepticism among investors surrounding the sector, initially. The UK government stepped in to support the development of offshore wind through the use of CFDs, which gave private sector investors the comfort that they were going to make an economic return on their investment. As the sector has become more established and familiar to investors, the level of support that is required has dropped significantly.

We need more of this type of targeted intervention to enable the new solutions to emerge. At the moment, the UK government has set out a high-level plan for reaching its energy transition objectives. But reaching those goals by 2050 is going to require a lot of work right now. In some exciting and important areas, the government needs to do more to help make projects viable for investors like us.

ML: That is super important. As Ed says, there have been some great examples where government has been an excellent crowding-in agent using support mechanisms such as feed-in tariffs and CFDs. But there are so many potential solutions when it comes to something like transitioning domestic heating. Do we use ground source heat pumps, air source pumps, hydrogen or utilise carbon capture and storage solutions? It's a bit like Betamax versus VHS. You need to make sure you back the winners.

Of course, we still need to maintain that spirit of entrepreneurialism and innovation. But if we want to attract significant capital there ideally needs to be a greater degree of certainty. No one wants to end up with stranded assets because the economy has gone in a different direction. Greater support and clarity are required to help keep the current momentum going.

implemented across a broad church of opportunities.

We've been involved in a significant number of fibre optic broadband roll-outs, for example, both through our brownfield and greenfield strategies. You might not immediately think of fibre as being an energy transition asset. Except, of course, the provision of such crucial communications infrastructure creates added flexibility in the way we work, for example, by reducing the need for international travel. The impact on sustainability and the climate is actually pretty profound.

Then there is a whole array of more classic energy transition opportunities, ranging from renewable generation to solutions which improve the sustainability of hard-to-reach parts of the industrial landscape. We recently committed to a company called Energy-Nest, a thermal battery business which specialises in capturing what would otherwise be surplus industrial heat and storing it for later use. My point is that there is a huge range of businesses that are contributing to the energy transition. It might be easier to ask what a dedicated energy transition fund would leave out? It touches everything.

Q Have LP attitudes towards risk and return changed as a result of covid?

ML: Whenever there is a major event that impacts the economy, people tend to rethink their risk exposures and we have seen that, to some extent, in the infrastructure space. Thankfully, by and large, core infrastructure has performed as expected, with notable exceptions such as airports. But we have seen a slight shift towards core, utility-like investments and greater scrutiny where there is high patronage risk or GDP exposure. That is typical of any shock to the system, and there's certainly been a shock due to covid-19.

Q Is it becoming harder to find assets that meet that desired risk/return profile,

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particularly in the increasingly popular sustainability space?

EC: As in any market, when something becomes popular, prices tighten. Wind and solar have gone from being fringe assets that governments had to subsidise heavily to get people to invest in, to largely unsupported, mainstream assets that, in some cases, produce energy that is cheaper than traditional sources of power. Clearly, returns have come down as investors have become more and more comfortable with the sector.

Where we can add value for our investor base, however, is by getting involved in new areas of sustainable infrastructure: thermal battery technology;

energy from waste; industrial energy supplies. There is a plethora of less well-developed sectors where there are still long-term contracts available, offering infrastructure-like characteristics, as well as more attractive returns. We try to get in at the front end of those trends.

Q How do you decide when is the right time to invest and how do you deal with technology risk?

EC: Zenobe is a case in point. Everyone understands how batteries work. The technology isn't uncertain. What is uncertain is how that technology is going to be used. The evolution of battery use for buses, for example, has taken place very quickly over the past two years. There was no question that the technology would work.

What is new is bringing all the different components together and creating a product that can provide seamless service at a price that encourages bus companies to transition away from diesel. In other words, we wouldn't invest in an unproven technology, but we do like to help scale up emerging but proven concepts.

Q How have LP attitudes towards sustainability evolved?

ML: It's long been the case that certain investors avoid exposure to more challenging areas. There are some LPs that won't go near fossil fuels at all. But I think it's the transition angle that is most interesting. Aspirations to reach net-zero carbon tomorrow may be laudable, but the reality is that there's still a lot of work to do. The alternatives simply aren't there today at the scale and sophistication required to make the transition in such a short timeframe.

Private markets investors are typically on top of those themes. They have opinions. They challenge us. And they work with us to ensure we're moving in the right direction. ■