# Green Infrastructure Fund

Q4 2023 Commentary

Performance with principles®

## PERFORMANCE

| | 3 Months | 6 Months | 1 Year | ITD* |
|---|---|---|---|---|
| Fund Performance (B Class) | 6.7% | 0.6% | -9.7% | -5.0% |
| IA Infrastructure | 7.0% | 1.5% | -2.8% | -5.2% |
| Sector Quartile | 3 | 3 | 4 | 3 |

Source: Morningstar. Figures compared on a Bid to Bid basis with Net Income Reinvested. *Inception: 28 September 2022

## MARKET REVIEW

The final quarter of 2023 delivered an overdue recovery for listed green infrastructure, following a period of negative performance. The quarter initially got off to a bad start when US 10-year Treasury yields rose to their highest levels since 2007, which, combined with strong economic data made it seem unlikely that rate cuts would materialise anytime soon. This was viewed as negative for renewable energy developers, many of which tend to sign long-term fixed price contracts while retaining exposure to rising costs. Orsted, the world's largest offshore wind developer (not held), reported a huge net loss of DKK 22.6bn (approx. £2.6bn) driven by large impairments caused by cancelled projects, supply chain delays and higher rates. Our investments, however, are focused on incumbent owners and operators of renewable energy infrastructure rather than developers, meaning they are not exposed to rising construction costs, but benefit from inflation-linked revenues.

Hamas's attack on Israel on October 7th led to crude oil prices surging on fears of a broadening Middle East conflict. Market participants gravitated towards haven assets, bringing Treasury yields down again, improving the outlook for infrastructure valuations. At the beginning of November this trend was consolidated and, listed infrastructure rose sharply after the Fed left its benchmark rate unchanged at the 5.25% to 5.5% range, indicating a potential end to the rate hiking cycle. This was followed by data indicating a cooling US jobs market and slowing inflation, further cementing the market view that we had hit peak rates. Listed infrastructure maintained its positive momentum throughout the rest of the quarter.

## PERFORMANCE & ACTIVITY

The fund rose sharply over the quarter. All financial categories within the fund generated positive returns but, in a period of volatile – albeit now rising – markets, it was our diversifiers that generated the strongest returns. This was driven primarily by our top-performing holding over the period, which was the wind turbine installation vessel owner and operator Cadeler. The company successfully completed its merger with Eneti, making it now by far the biggest player in the industry. In our view, the market for installation vessels is likely to remain undersupplied and the business is likely to continue to benefit from strong day rates for its vessels.

Another one of this quarter's top performers was Gore Street Energy Storage, one of the previous quarter's worst performers. It delivered interim results that demonstrated the benefit of its international diversification in providing robustness in the face of a challenging British battery revenue environment. Gore Street Energy Storage also confirmed a strategic partnership with Nidec, whereby the Japanese company agreed to subscribe to 14m new ordinary shares in the company issued at NAV, thereby providing further assurance about the validity of NAV despite the shares continuing to trade at a steep discount to the value of the underlying assets. This is alongside the continuation of the trend of companies in the sector selling assets at valuations above book value, further confirming NAVs. Foresight Solar Fund (held), for example, announced an agreement to sell half of its 99MW Lorca portfolio in Spain for €26.9m, representing a 21% premium to NAV.

Among noteworthy transactions over the quarter, we started increasing our position in Triple Point Energy Transition at the beginning of the quarter. The stock was trading at a more than 40% discount to NAV, offering a yield close to 10%, backed by over a decade of primarily contracted revenue visibility. The opportunity to make an investment with such characteristics was primarily provided by the market imposing a steep discount on the stock due to its small size and low liquidity. We took the view that we were being more than adequately compensated to bear this liquidity risk, given that the fund is still of a size that allows us to be nimble and take advantage of such opportunities. Subsequently, we found ourselves in the strange position of being disappointed to be vindicated in our investment thesis; the company announced it would propose an orderly realisation of assets to crystalise the value represented by the discount to NAV, leading to the stock rising sharply. While we anticipate this be a highly profitable investment for the fund, it is a bittersweet outcome, given that a promising business is being wound up due to market conditions.

News relating to positive environmental outcomes from our holdings included the following:

- Atrato Onsite Energy published a statement on the occasion of its two-year anniversary, telling the market that it had reached a portfolio capacity of 182MWp, and that its portfolio had generated 13,500 tonnes of carbon savings.
- Foresight Sustainable Forestry (FSF) reported on the visit of Scottish Cabinet Secretary for Rural Affairs, Land Reform and Islands, Mairi Gougeon to their Fordie Estate, stating that FSF had woodland creation schemes representing 22% of the annual planting target in Scotland and 40% of the planting that was achieved last year. In addition to direct environmental impact, the company's afforestation programme across the UK is anticipated to create 700 rural work opportunities in the planting stage and 35 long-term full-time equivalent jobs. To support this, they expanded their forestry skills training programme earlier in the year.
- Canadian Solar Infrastructure announced its latest CO2 reduction data, showing CO2 reduction of 448,805 tonnes between October 2017 and November 2023.

## OUTLOOK

Infrastructure business models truly did prove themselves in 2023. It was rational for investors to be worried about the effect of rising discount rates on valuations, but the actual effect of those rising discount rates was mitigated by factors such as inflation-linkage, precisely as intended by the prevailing business models. Even with inflation coming down again, most infrastructure companies have been conservative with the inflation assumptions in their asset valuations, so strong inflation – even if declining – remains a tailwind for the sector. Even after the recent share price recovery, listed infrastructure discounts to NAV remain at historically wide levels despite companies demonstrating an ability to generate strong inflation-linked revenues and NAVs remaining resilient. We believe this provides long-term investors with plenty of interesting investment opportunities.

Potential catalysts for a rerating of the sector include stabilisation in the interest rate outlook, a transition to a market regime that values stable earnings against a recessionary backdrop, and evidence of self-help from individual companies with the ability to repower end-of-life assets or use active asset management to get more out of operating assets. With this in mind, it is important for us to maintain exposure to names with proven track records of managing their assets well and with strong cash-backed dividend streams. Furthermore, we expect to see more corporate activity in 2024, both in terms of asset sales to release capital for investment in accretive pipeline opportunities and confirm NAV, and in terms of M&A to consolidate smaller players in the industry, which, as we have already seen, can give rise to some interesting special situations.

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| PERFORMANCE DISCRETE | 12 Months to 31/12/2019 | 12 Months to 31/12/2020 | 12 Months to 31/12/2021 | 12 Months to 31/12/2022 | 12 Months to 31/12/2023 |
|---|---|---|---|---|---|
| Fund Performance (B Class) | | | | | -9.7% |
| IA Infrastructure | | | | | -2.8% |
| Sector Quartile | | | | | 4 |

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