Adapting to a post-incentive world

Nicolas Rochon, founder and managing partner of RGREEN INVEST, explains how the post-incentive era has opened up new markets and changed the way his firm invests across Europe

Q How has the shift from a policy-driven market to an economically viable one affected your role as an investor in Europe's energy transition?

Nicolas Rochon: I started investing in the energy transition in 2003. Ten years later, RGREEN INVEST launched its first fund. At that time, the market was very much policy-driven. There was strong state support to finance the expansion of the sector, with long-term contracts and high cashflow visibility. As a result, governments were a key part of our risk assessment since political stability was critical when underwriting government-subsidised revenues. We primarily had to invest in mature markets such as France, Germany and the Nordics. Southern and Eastern Europe were riskier markets to operate in.

Things changed around 2015. The alternative energy market became increasingly competitive. The issue moved away from getting comfortable with government risk to focusing increasingly on the ability to produce alternative energy more efficiently.

With nuclear energy occupying an important part of the energy mix, France's cost of electricity production has remained low. As a result France does not invest in renewables to decrease the cost of energy, but rather to reduce its carbon footprint in order to meet the targets set out in the Paris Agreement on climate change.

If you look at Southern and Eastern European countries, such as Spain, Italy and Greece, those markets are becoming increasingly attractive thanks to the combination of high market prices and abundant renewable energy sources.

Our first two funds, launched in 2013 and 2015, were more than 75 percent invested in France. The latest one, which closed in January this year, has already deployed 70 percent of its €307 million, and should be less than 30 percent invested in France. Renewable energies have no boundaries, and as long as interesting opportunities arise, we will consider them.

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Q Your geographical remit has changed as a result of the move away from incentives. What about the nature of the investments you make?

NR: We have been able to adapt to this shift by allowing ourselves to use a broader range of solutions. Our instruments now range from equity to junior debt or mezzanine, in order to capture the best risk-return opportunities depending on the geography and the technology. INFRAGREEN I and II invested mainly in debt through bonds and convertible bonds. But with the shift away from an incentive-based environment we increasingly consider equity investments. INFRAGREEN III should be fully invested by Q4 2019, with two thirds in debt and one third in equity. When investing in equity we invest alongside our historical partners to benefit from added operational and technical expertise.

We are going to launch INFRAGREEN IV later this year with a €500 million target, and 50-50 mix between equity and debt.

Q What sectors do you see as particularly interesting?

NR: The sector very much depends on the geography. In Southern Europe, solar is naturally attractive. Poland has optimal wind conditions and biomass can be interesting in locations such as Croatia, where wood resources are abundant.

We also see energy storage as an appealing opportunity. Storage systems are required to stabilise the network owing to intermittent renewable energy production. We have already made some energy storage investments in France. The industry is still nascent, but we expect to see a lot more over the next two to three years.

Distributed energy generation and clean transportation are also interesting areas. We believe that energy transition is not only linked to clean energy production, but also to energy efficiency. We expect also to see a lot of opportunities coming from that side of the equation.

Q Has the shift away from incentives changed the stage of investment that you focus on?

NR: The development risk is less important when you are not pressurised by hard deadlines to secure incentives. The main criterion is no longer to secure an attractive feed-in tariff, but rather to use the most adapted technology in a given location. We can now get involved at an earlier stage than the usual 'ready-to-build' or 'turnkey' stages. This is the strategy we are implementing in Italy and Spain, for instance. Our investment decision is based on our forecast of the average levelised cost of energy for the next five or 10 years, and not on policy incentives. In those circumstances, we are prepared to take on development risk – it accounted for just under 10 percent of our last fund. But when subsidies are involved, we will only invest at the construction or brownfield stage. The mix of stages reflects our investors' expectations of a balanced risk-return profile. The financial instruments used also have an impact.

Q How are the competitive dynamics of the market changing?

NR: Back in 2003, we were one of the first independent players in this market. Competition has increased, in particular for big projects with strong feed-in tariffs and long-term cashflows. Overall, however, there aren't many specialist firms such as ours with strong historical ties to independent mid-sized developers, so the market remains big enough for us.

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We do not compete with the big infrastructure funds as our deals are still too small for them – our average investment size is between €15 million and €20 million. Competition only starts to really kick-in on transactions valued between €50 million and €100 million, where there is also a significant consolidation among players.

Q Where you do face competition, does it come down to price or are there other factors involved?

NR: Price is part of it. Another way to secure a project is to get involved at an earlier stage. But RGREEN INVEST's true added value is the quality of its relationships with robust independent developers. We have been working with our partners for years and provide tailor-made financing solutions to meet their specific requirements. Furthermore, we often invest alongside these partners. This gives us a strong edge over the competition.

Q How would you describe underlying investor appetite for specialist energy transition funds?

NR: Overall, investor appetite is strong and I see three main reasons for this. First, renewable energies are driven by strong top-down objectives, such as those outlined in the Paris Agreement. Second, the technologies are now mature and renewable energy is a profitable asset class on its own. And third, as we can see in France, local regulations are encouraging LPs to invest in this asset class. They are able to invest over a sufficiently long timeframe to support the energy transition.

Q Incentives are no longer required. But what additional support would you like to see from European governments to facilitate investment in the energy transition?

NR: We don't need price support anymore, but we do need simplification in terms of the permit process. Of course, it remains crucial that environmental studies are performed thoroughly, but any streamlining of the development process would be beneficial.

Q Finally, what's next for the energy transition in Europe?

NR: It is just a beginning. Over the next 10 to 20 years, renewables will become a far bigger part of the energy consumption mix in Europe. A lot of new technologies are being developed and our approach to the distribution of electricity will be overhauled. I feel highly optimistic for the sector, and for RGREEN INVEST to play a key role in the energy transition. ■