MACKENZIE
Investments

Mackenzie Greenchip's quarterly update

Key takeaway

> Several holdings in the renewable energy space have recently sold some of their assets to private equity firms at what we consider to be very generous premiums. This raises the question: are publicly listed renewable utilities undervalued, or are private equity strategies focused on renewable energy overvalued?

Let me start this quarter's letter with this: The solutions that our companies provide have never been needed more in this world. Existing energy and resource efficiency infrastructure, the molecules and materials needed to build more of them, new chemistries to enable cleaner industrial and agricultural processes, and so on, have never been more valuable...period.

That said, value and price are not always aligned, and pricing assets has never been more difficult. Systemic risks keep mounting: inflation, increasing credit costs (and decreasing availability), energy security, and of course a highly unpredictable war. It is all well reported in the media, and I don't feel there is much value piling on. However, one security pricing consideration that has received far less attention than it deserves is liquidity, and there is an interesting connection here to our space.

We are observing a possible inversion in the so-called "liquidity premium" — the term used to describe the enhanced return that is traditionally expected for investing in illiquid assets — in recent sustainable asset deals. Our conclusion is that, generally, we believe that *publicly listed* renewable utilities are undervalued, and/or, that *private equity strategies* focused on renewable energy are overvalued.

Buyout activity blooms

Boralex (not currently a holding of the team) recently sold a 30% stake in its French assets, a portfolio currently operating around 1GW of wind power and a good development pipeline. The buyer, Energy Infrastructure Partners, a large Swiss private equity firm, paid a price of US$766 million. A National Bank analyst estimated that transaction was completed at a value of 14-16x cash flow. From that, we would put the price at about US$2.5 million/MW. This is a company we held in our portfolio for 13 years — we know it well. Our view is that the buyer paid about *double* the original development cost.

SSE, a Scottish renewable utility currently held in the Greenchip portfolio, recently sold the equivalent of 120MW in its Dogger Bank C offshore wind project for £68 million. On the surface, it might seem the buyer got a wonderful price, until one learns that the entire Dogger Bank asset has no turbines yet. The buyer Eni, an Italian oil company, essentially paid £68 million for an underwater land lease. From our perspective it was instead an exceedingly attractive deal for our holding, SSE.

Author

John A Cook, CIM
Senior Vice President, Portfolio Manager
Team Co-Lead

Author

Greg Payne, CFA, PhD
Senior Vice-President, Portfolio Manager
Team Co-Lead

During the summer, another Greenchip holding, Veolia, a global waste management, water and energy services company, reached an agreement to sell its UK waste management business to Macquarie. We valued the transaction at about 17x EBITDA. In the past few weeks, it looks like a rival consortium including private equity investors might bump Macquarie from the deal. The important thing is the price paid seems excessive to us. Particularly when you consider that Veolia purchased the asset as part of their SUEZ deal for about 9x EBITDA, and Veolia itself currently trades at only about 6.1x EBITDA.

Valuation disconnect

As holders of several listed renewable utilities, we welcome these rich private transactions. They seem to be closing at much higher cash flow multiples, often in the mid-teens or even higher. For reference, our holdings in Energie de Portugal, Enel, Engie and SSE are currently trading at 9.5x, 6.2x, 4.7x, and 6.6x forward EV/EBITDA respectively.

These are just anecdotes, but we have several more transactions along the same vein that we could have included. One perspective might be that there is simply too much private capital chasing too few infrastructure assets. The other is that our listed utilities are worth much more than where traded markets are currently valuing them.

This is what **The Economist** had to say about the issue on October 4: “Alternative assets [which includes private equity] have grown from just 8% of total financial assets in 2006 to 15% now. They have taken paper losses of 11% on their investments this year, a much smaller fall than in the public markets. This might reflect sensible investment strategies—or an unwillingness to adjust to reality.”

Summary

Private equity firms are eager to buy renewable utilities, and willing to pay what we consider to be high premiums on these assets. This suggests there is strong competition among private investors, and that publicly traded utilities with an integrated focus on renewables may see a dramatic rise in their valuations.

2583163 11/22