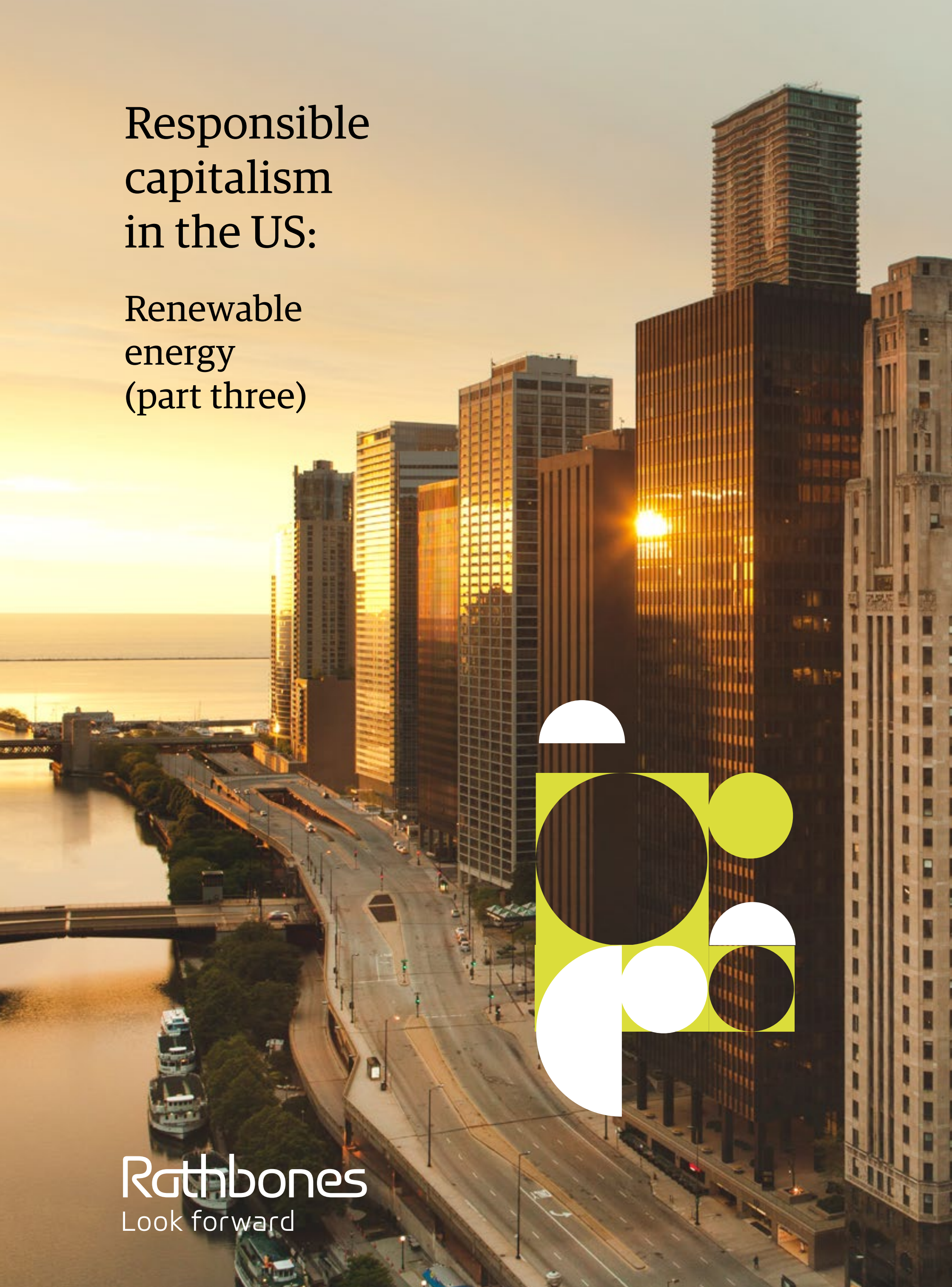
# Responsible capitalism in the US:

## Renewable energy (part three)



Rathbones
Look forward

Rathbone Global Sustainability Fund manager **David Harrison** explains how the rise of renewable energy is helping to reduce emissions and create a more sustainable world.

David is the lead fund manager of the Rathbone Global Sustainability Fund, supported by Liz Davis and Neil Smith.

He joined Rathbones in 2014 and has 20 years' experience in equity analysis and fund management, including positions at Hermes and Goldman Sachs.

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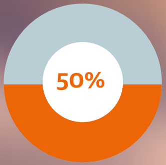
Renewable energy has always played a minor role in the US energy market. While the movie industry has long portrayed California as being awash with wind turbines, its silver screen fame far exceeds its output. Even today, wind energy accounts for just shy of 10% of the US's electricity production; not totally insignificant, but a minor player nonetheless.

Even so, there are signs that renewables are beginning to gain greater traction in the US – and elsewhere in the world – as the overall drive for sustainability takes hold. Indeed, renewables are forecast to account for around 25% of the US energy generation mix by 2050.[1] On top of this, since 2019 we have seen 10 US states, more than 100 cities, and a number of major US corporations committing to renewable energy targets. At a global level renewables have a stronger foothold, at around 26% of total electricity generation, and there are predictions that this will rise to nearly 50% by 2050.[2]

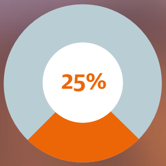
1 EY accelerated energy transition

2 Bloomberg new energy outlook 2019

**Predicted global renewable energy generation in 2050[2]**




**Forecast USA renewable energy generation in 2050[1]**




The noticeable rise of renewable energy echoes the transformation I've observed in other US industries, where a combination of increased awareness and customer demand are effecting significant change. In the previous two chapters in this series, I discussed how US consumers and companies alike have become more aware of how their consumption affects the world around them, and how technology has an important role in enabling a more sustainable future.

Whether it is the trend towards plant-based diets, the rising popularity of greener forms of transportation, or the noticeable effort among corporations to address environmental and societal issues, I got the feeling that a societal shift is underway. In a country where fossil fuels are king and currently produce around 80% of its energy, this is a major development. It's clear that there is a desire in society and government for change, and steps are being taken to achieve it.

There is little doubt that non-hydro renewable energy, led by solar and wind power, are on a solid growth trajectory. Nevertheless, this is a slow-moving trend that will be played out over several decades rather than in a few years.

# The great energy rotation

One reason for this is that the shale gas revolution of the past decade had a major influence over the US energy market; the switch to natural gas power plants from their dirtier coal-fired cousins is helping to drive down carbon dioxide emissions from electricity by 26% between 2008 and 2018.[3] With cleaner shale gas being abundant and at an attractive price, it was the logical choice for many power generation companies.

3 US Energy Information Administration Monthly Energy Review May 2020

Helping to drive forward the case for renewables is the fact that, in many regions, wind power is now the cheapest form of energy generation. Analysis by the US Department of Energy at the end of 2019 found that wind farms are cheaper to build and operate than gas-fired power plants.

The cost of wind power in the US had in fact increased steadily up until 2009, when power purchase agreements for wind-generated electricity peaked at about $70 per megawatt-hour. Prices have declined steadily since then, with the national average falling below $20 per megawatt-hour for the first time.

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In Europe, renewable energy gained a larger foothold much sooner than in the US. The share of renewable energy in gross final energy use in the EU has doubled since 2005, according to data from the European Environment Agency. By 2018, renewables accounted for 18% of all energy use in the European Union (EU), with renewables accounting for 30.7% of electricity consumption.

# Seeking exposure

**Given the renewable energy market's potential for growth, there is little doubt that it can be an attractive investment opportunity.**

The objective of the Rathbone Global Sustainability Fund is to create long-term value for investors, society and the environment through companies that display strong environmental, social and governance (ESG) principles and follow a sustainability theme. The companies that I select for the portfolio are therefore high-quality, cash generative businesses with strong franchises, have no financial stress and are long-term thinkers.

As a fairly niche market, the options in renewable energy are admittedly limited compared with other industries. For starters, many wind turbine manufacturers are subsidiaries of larger industrial conglomerates, such as General Electric or Siemens, which means they may not be pure-play renewable energy investments. Others, meanwhile, may not be attractive from a profitability and cash-generation standpoint. For this reason, less than 10% of the Rathbone Global Sustainability Fund's portfolio is invested in renewables.

Nevertheless, when we look only at the companies that are fully focused on renewable energy, a few shine through as ticking all of the right boxes. In the US, we found an opportunity with companies that finance and develop energy-efficient buildings and renewable energy-generation projects. One example is Hannon Armstrong, which provides loans to customers to help them finance projects in the following areas: retrofitting buildings to make them more energy efficient and installation of solar panels in the residential housing market. The company also invests in wind power and leases land to be used for large solar farms.

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Outside of the US, companies such as Vestas and EDP Renováveis are examples of high-quality operators in the renewables sector that complement each other, rather than overlap. Vestas is the largest wind turbine manufacturer in the world, with an order backlog in the region of €32.8 billion.[4] It faces stiff competition from the likes of Siemens Gamesa Renewable Energy, Goldwind and General Electric, but it is in a strong position because it is seen as a leader in the renewable energy sector and has a strong business model. It is protected by high barriers to entry and is well placed to capitalise on the growth of the wind energy market as the world moves away from fossil fuels.

4 Barron's Vesta article

EDP Renováve (EDPR), on the other hand, finances, builds and operates renewable energy projects including solar as well as onshore and offshore wind farms from start to finish. It will either retain ownership of the project or it may sell the asset to another investor, such as a pension fund, and then continue to operate the site under a management agreement. As a group, EDPR, Hannon Armstrong and Vestas represent most of the supply chain in renewable energy, from financing a project to the provision of infrastructure and then the ongoing management and maintenance.

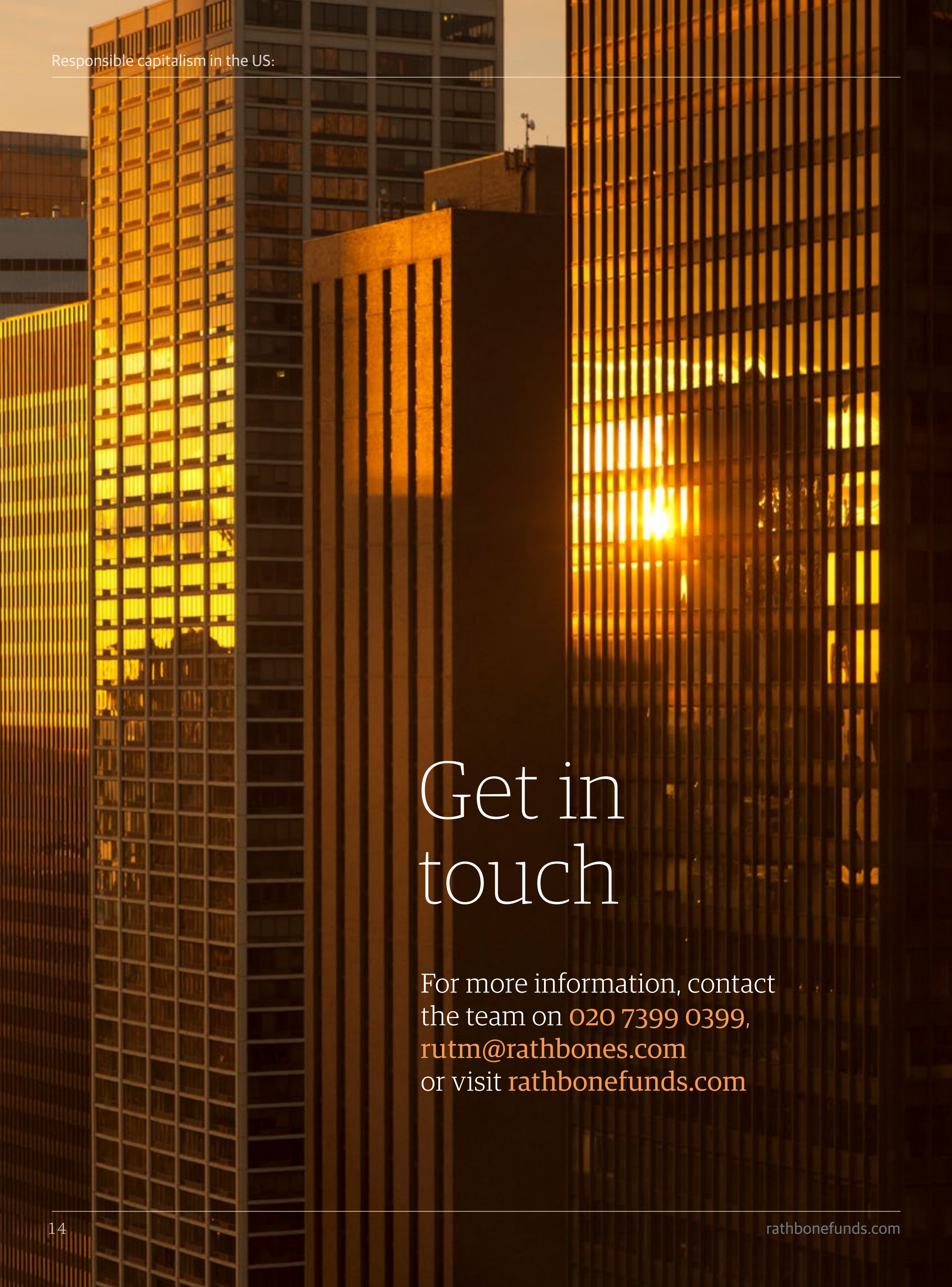
# Towards a sustainable future

Sustainable investing is as much about environmental factors as it is about social and governance concerns.

When we think of responsible capitalism, the first thing that comes to mind is doing the right thing. Regardless of sector or industry, the most successful companies in our evolving society will likely be those that have sensible management teams, a clear focus on sustainability in their operations and the products they provide, and a business model that offers solid revenue and durability of returns over the long term.

Simply investing in a wind turbine manufacturer because it contributes to a sustainable form of electricity is not good enough. The company needs to be a solid performer not only from a financial perspective, but also from a sustainability perspective.

Sustainable investing is as much about environmental factors as it is about social and governance concerns. In the US as well as the rest of the world, it's clear that we are beginning to see a societal shift towards greater awareness of how our actions impact on the environment and our communities. The companies that are most successful at establishing a strong market position and building a positive and sustainable business model stand a good chance at delivering over the long term.



# Get in touch

For more information, contact the team on 020 7399 0399, rutm@rathbones.com or visit rathbonefunds.com

1 https://www.ey.com/en_us/power-utilities/in-an-accelerated-energy-transition-can-us-utilities-fast-track-transformation
2 https://about.bnef.com/new-energy-outlook/
3 https://www.eia.gov/totalenergy/data/monthly/
4 https://www.barrons.com/articles/worlds-largest-wind-turbine-maker-vestas-climbs-on-record-orders-51573132569



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