Partners Group
REALIZING POTENTIAL IN PRIVATE MARKETS

The great Australian renewables opportunity

Q&A with Tim Michalas and Nandan Balachandran

Murra Warra I Wind Farm, Private Infrastructure

Following our recent investment in Murra Warra II Wind Farm, Nandan Balachandran and Tim Michalas from our Private Infrastructure Asia team discuss the advantages of wind farm platform strategies, the rigors of transacting in the midst of a global pandemic, and the next generation of energy transition investments across Asia Pacific.

You just completed the second phase of your platform buildout with Murra Warra II. How did Partners Group manage to close such a significant investment in this environment?

Nandan Balachandran: We completed the acquisition of Murra Warra I back in 2018. Murra Warra II was then in the pre-development phase, but the two sites were right next to each other, so we had visited the site many times and we also had strong relationships with the sellers. So, when the project reached the stage at which it became investable for Partners Group - around the point of financial close - we were already well-prepared.

Furthermore, due diligence work on this project really started more than 12 months ago. COVID-19 did disrupt travel plans and both we and the sellers took some time to reflect back in March-April, when the extent of restrictions to be imposed was unclear. But when the process progressed, we were already very advanced.

From there on, the challenge was coordinating due diligence and negotiations remotely. And while a few approvals were delayed by travel restrictions, there were two things that played in our favour – we knew the sector and asset well, and we had completed the majority of the due diligence before lockdown began.

"While we have been active in the Australian renewables market, we have also been extremely selective. To- date, we have only invested in wind farms because that is where we see relative value."

This is Partners Group's sixth renewables deal in Australia. What makes this market particularly attractive?

Tim Michalas: We are very focused on certain themes that we identify through our Thematic Sourcing strategy. In Australia, around 60% of the coal fleet is set to be retired over the next 20 to 30 years and renewables are reducing substantially in cost. You have a rise in distributed generation and you have world-class solar and wind resources. All that points to a long-term transition from fossil fuels and so this is a theme we find very attractive.

NB: I would add that while we have been active in the Australian renewables market, we have also been extremely selective. To-date, we have only invested in wind farms because that is where we see relative value. Solar, for example, may be attractive in other markets such as Japan, Taiwan or the Philippines, but, in Australia, it doesn't stack up on a risk-adjusted basis.

Wind, on the other hand, continues to be attractive but you still have to stay selective. Murra Warra II, for example, is contracted under a long-term power purchase agreement.

Why does a platform expansion strategy, such as Murra Warra, make sense?

NB: Single assets may be attractive on their own merits, but sometimes, particularly in the renewables space, they are too small for the size of equity investment we want to make. However, platform expansions, where we enter into an agreement or form a relationship with the developer and gain access to their pipeline, can be a win-win.

Developers are seldom working on just one project. They generally have a number of projects at different stages, and they have to go back to market to raise equity and debt for every project that they develop. This can be a time-consuming process and is a distraction from their main focus of development. For us, meanwhile, there is an advantage in knowing we are working with an experienced developer that is focused on the type of quality, location and capacity factor that we favor.

That is exactly what happened with another platform we have in Australia, Grassroots. We did one project with the team, there was a meeting of minds and we decided to create a platform whereby we get access to the pipeline and the developer gets financial security. The situation was very similar with Murra Warra. These things don't always happen, but when they do, we try to seize the opportunity.

"Renewables have proven pretty resilient in the face of market dislocations. In fact, our infrastructure portfolio significantly outperformed its public infrastructure benchmark during H1 2020, in part due to our exposure to renewables."

What is the solution to the intermittency challenges that renewable energy presents?

TM: Almost all of our power in the region is sold on an intermittent basis. We see grid firming as a separate investment opportunity. Demand for grid firming will certainly grow over time, particularly as dispatchable coal retires and renewables penetrate more and more into the system. Intermittency management is a key theme that our global research team is exploring.

At the moment, there are three key technologies – gas, pumped hydro and batteries – that are likely to play a significant role, particularly in a market like Australia where we have some amazing pumped hydro opportunities. Hydrogen also has potential, although we struggle to see many investable projects right now.

How has the renewables sector been impacted by the ongoing global health crisis?

TM: The impact of COVID-19 has of course been felt across all sectors globally. That being said, at Partners Group, the infrastructure assets we invest in on behalf of our clients are all contracted, with high-quality offtake counterparties, therefore the impact on operating assets has in fact been minimal, in contrast to patronage-linked assets, such as toll roads or airports. We do have some assets in construction, so there has been some impact there, but in the vast majority of cases we carry very little risk with respect to the construction itself.

The Australian government, and other governments around the world, regard electricity generation as an essential service, so we have spent a lot of time making sure our worksites are safe and productive as they continued to operate throughout the pandemic. Overall, renewables have proven pretty resilient in the face of market dislocations. In fact, our infrastructure portfolio significantly outperformed its public infrastructure benchmark during H1 2020, in part due to our exposure to renewables.

What investment opportunities do you see in Asia beyond the energy space?

NB: Globally, we invest on a relative value basis. That means, every six months, we sit down as a team and discuss what is attractive, and what is not, across the region. Those discussions go up the chain to the relative value committee, who give us their top down view on what they are seeing around the world. Together, we form a view on the attractiveness of various sectors within infrastructure on a relative basis – that helps us focus our origination efforts.

In addition to renewables and grid firming, we also like the communications space – data is a theme we have been looking at for a while. With data centres, it comes down to the kinds of contracts that are in place; where you have a contract with creditworthy counterparties, such as the Amazons and Googles of the world, then that very much becomes the type of infrastructure business that we invest in. That is true of developed markets such as Australia, as well as developing markets in Asia.

Telecoms towers can be interesting too. Australia is a very saturated market and it can be difficult to find opportunities. But in other parts of Asia Pacific where mobile coverage is expanding, it can be an attractive space. Finally, waste-to-energy is a sector we are watching closely in Australia. Only two large transactions have reached financial close so far, but it is a theme we expect to continue as we can see from countries like the UK where waste-to-energy is more mature.

Increasing waste volumes and government plans for a circular economy, play into this. Obviously, policy has taken a backseat during the pandemic, but we are convinced it will return.

And just what resources - and experience - does it take to be successful?

TM: In addition to our centralized research team, who are vital to supporting our Thematic Sourcing approach, it is important to note that in the renewables sector we see most value in construction projects. We want to develop and build core assets that will be attractive to low cost of capital buyers.

That involves spanning the development phase, where contracts are put in place; the construction phase, where contractors need to be managed; and the operational phase as well. It requires experience to strike the right balance in risk allocation and working with contractors, managing the process such that we do not experience avoidable costs or delays.

Our approach has been to invest substantially into our asset management and value creation capabilities. Over the last few years, we have built up a global team of approximately 60 asset management and value creation professionals, across all asset classes, with Partners Group appointing more than 80 board members to our direct infrastructure assets. Construction comes at a risk premium, offering higher equity returns. But you have to have the capabilities and resources to get it right.