AQUILA CLEAN ENERGY

Navigating the challenges of 2023 & gaining momentum for 2024

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2023 presented many challenges for businesses and economies worldwide. From higher interest rates to ongoing supply chain disruptions and two large-scale wars, navigating the macroeconomic landscape was no easy feat. However, amidst the challenges, there are signs of optimism for 2024.

Navigating the Challenges of 2023

First, let's talk about the impact of higher interest rates on businesses. A well-known story now, but higher borrowing costs necessitated cautious financial planning and more than ever, prudent cost management. Relying on a relative "free flow" of capital for a long time, many businesses had to reorient their strategies. Some companies that could not monetise their offering and faced a funding crunch had to shutter their doors or significantly reduce their prior expansion plans which had relied heavily on this very accessible capital flow. In the clean energy industry, there was still capital to access but the cost of financing and the knock-on effects for project returns were impacted, leading to delays in projects or even some being abandoned. That said, the industry players with a long-term outlook, the ability to structure and de-risk exposure and projects with strong fundamentals were able to stay the course, albeit with tempered returns than in prior low interest rate environments. Early signs indicate that monetary tightening may be working as planned, though, because as we start 2024, estimates show rates going from 6.5% in 2023 to 5% in 2024.

Furthermore, the supply chain disruptions, which were worsened by geopolitical issues, seem to show some sign of ameliorating as well. As a matter of fact, one result is that supply chains have become more resilient. Through building long-term relationships across a variety of market sources and remaining on top of risk mitigation, we see projects coming to fruition even with components and parts that have become costlier and increasingly more challenging to source. While caution remains, with additional diversification of supply and more component manufacturers looking to enter the industry, I am cautiously optimistic we have seen the worst of the disruptions for now.

The full effect of the U.S.A.'s 2022 Inflation Reduction Act (IRA) – essentially the single largest law in U.S. history to tackle the climate and invest in clean energy – has yet to be seen, though in 2023 we saw early signs of Asia Pacific countries looking to secure their own domestic manufacturing and component supply while also benefiting from the potential surplus of components that may be diverted away from the U.S.A. .

2023 also ended on a promising note when COP28 showed that there is still momentum and an immense drive forward for clean energy. While a lot is required in terms of investment - we need to triple the current levels - there is no denying that we are on the right path. As a matter of fact, in Australia alone 2023 was a record-breaking year in new financial commitments to large-scale storage – AUD 4.9 billion in new commitments to be exact – and that was up 157.9% from 2022.

Looking Forward to 2024

As we look to the months ahead, there are encouraging signs. Despite the challenges of the past year, the Asia Pacific region continues to show resilience and dynamism, with economies poised for growth, commitments on decarbonisation in place (to varying degrees) and clean energy at the forefront of many policy discussions. In fact, the region is forecasted to invest over US$ 2 trillion in solar, wind, and battery storage till 2032. While the pace of renewable energy expansion may be more tempered compared to prior years in 2024, the underlying fundamentals are there and driven by robust domestic consumption, infrastructure investments, electrification and burgeoning digital economies we expect to see continued growth.

Moreover, the commitment to the energy transition remains a focus across the region. Governments, utilities, financial institutions and other stakeholders are doubling down on their efforts to accelerate the shift towards renewable energy. This commitment is underscored by the increasing deployment of renewable energy projects, power purchase agreements (PPAs) and the raising of renewable energy and infrastructure funds.

Japan, South Korea, Taiwan, Australia and New Zealand have set ambitious targets for renewable energy deployment by 2030, signaling a clear direction of travel towards a more sustainable energy future. These markets offer bankability and eco-systems that support project development, construction and operations, and tailwinds to support the energy transition.

Corporate Power Purchase Agreements (CPPAs), which enable businesses to directly purchase renewable energy from producers, are gaining momentum, driven by both environmental and economic considerations. On the environmental side, many corporates are seeking to deliver on their sustainability commitments related to reducing their scope 1 and scope 2 carbon emissions and are therefore looking to secure CPPAs for both their day-to-day business operations as well as any manufacturing or heavy industry they participate in. On the economic side, though many companies did not consider their energy costs a critical line item in the recent past, through securing a CPPA, they can lock in a set price for the negotiated term, thus ensuring supply and cost over time. We see this specific demand side need for clean energy particularly in Australia, New Zealand, South Korea and Taiwan. Additionally, there are new supportive policies in the region such as South Korea's Third Party PPA creating favorable conditions for Corporate PPAs. In 2023, Wood Mackenzie expected the APAC Corporate PPA market to end at 31.4 GW of contracted power, a big jump from 23.2 GW in 2022. Alongside the corporates, utilities are valuing contracting renewable PPAs as part of their portfolio to hit internal KPIs. The question remains, though, are there enough projects to go around and meet the numbers being demanded?

This trend is further supported by a robust pipeline of M&A in the sector too as firms look to increase their access to capital, bankable projects and expertise and shore up valuable development projects. Capital will continue to flow into regions with favorable structural growth drivers and strong political support for the sector as both governments and private sector players intensify their clean energy efforts through investment in solar, wind and battery storage.

Seizing Opportunities in Renewable Energy

In the near term, slowing inflation and improved supply chain conditions will enable business cases to be increasingly attractive and those players that can find projects that are further along will find capital deployment easier than in the recent higher inflation environment.

As renewable energy targets draw close towards the end of the decade, the demand for renewable energy supply is expected to surge and clean energy platforms that are positioned to take advantage of this will stand to do well. Furthermore, projects that offer multiple revenue streams or contracting opportunities will be well-positioned to capitalise on this. As the industry has become more popular over the last decade, returns are yielded by capturing the early stage of project development and creating value over the course of the lifecycle. In APAC three themes emerge to create value and make an impact on the energy transition, before the turn of the decade:

- SMART CAPITAL: Structuring, risk evaluation and technical analysis of early-stage projects may enable investors to deploy capital in a more efficient way and to yield higher returns during the development period. Smart capital invested this way will enable more projects to successfully be executed and commissioned. Having the right experts onboard with both deep subject matter and sector expertise can prove one of the best mitigants in evaluating external consultants' evaluations and studies.

- SPREAD THE PORTFOLIO TO MATCH THE GEOGRAPHIC DISTANCES; BUT STANDARDISE TO ENSURE QUALITY: Through diversifying the portfolio technology and country mix, firms can ensure that their regional development targets stay strong, despite certain political changes, or temporary setbacks in each respective market. At the same time, certain aspects of the development lifecycle can be standardised to enable quality across the portfolio, for example during development and construction.

- MANAGE THE 'UNKOWN UNKNOWNS': Early-stage development is not for the faint of heart. The ability to juggle multiple stakeholders across different geographies and the uncertainty that comes with creating value to bring a project from greenfield to reality requires process, rigour, focus and open dialogue to continuously problem solve and push forward. To do this effectively goes beyond traditional investment and portfolio management, however, the companies and teams that do this the best and largely bring development in-house or partner with the right experts, stand to do very well in the long-term.

While the challenges of 2023 were undeniable, they also served as a catalyst for resilience, innovation and adaptation. Though challenges remain, prospects for the renewable energy industry are positive. Projects that can stand on their own merit, without heavy reliance on government subsidies or incentives, are increasingly attractive to investors seeking returns. Developers and clean energy platforms that can execute successfully and manage risk, design and technical complexities early on – or "manage the 'unknown unknowns'", will see greater returns and be here for the long-term.

If developed correctly and built well, there will be more demand for green electrons than will be available. This is driven by environmental and economic considerations of corporates, consumers and current government clean energy commitments. Though the challenges have been manifold, I am optimistic the time for renewable energy remains and will accelerate towards the end of the decade, especially for those in the industry able to manage the macroeconomic challenges and geopolitical risk while building high quality projects for the long-term.