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Green Investing in Corporate Bonds

- combining sustainable and economic reasons

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Green Investing in corporate Bonds – for pure economic reasons

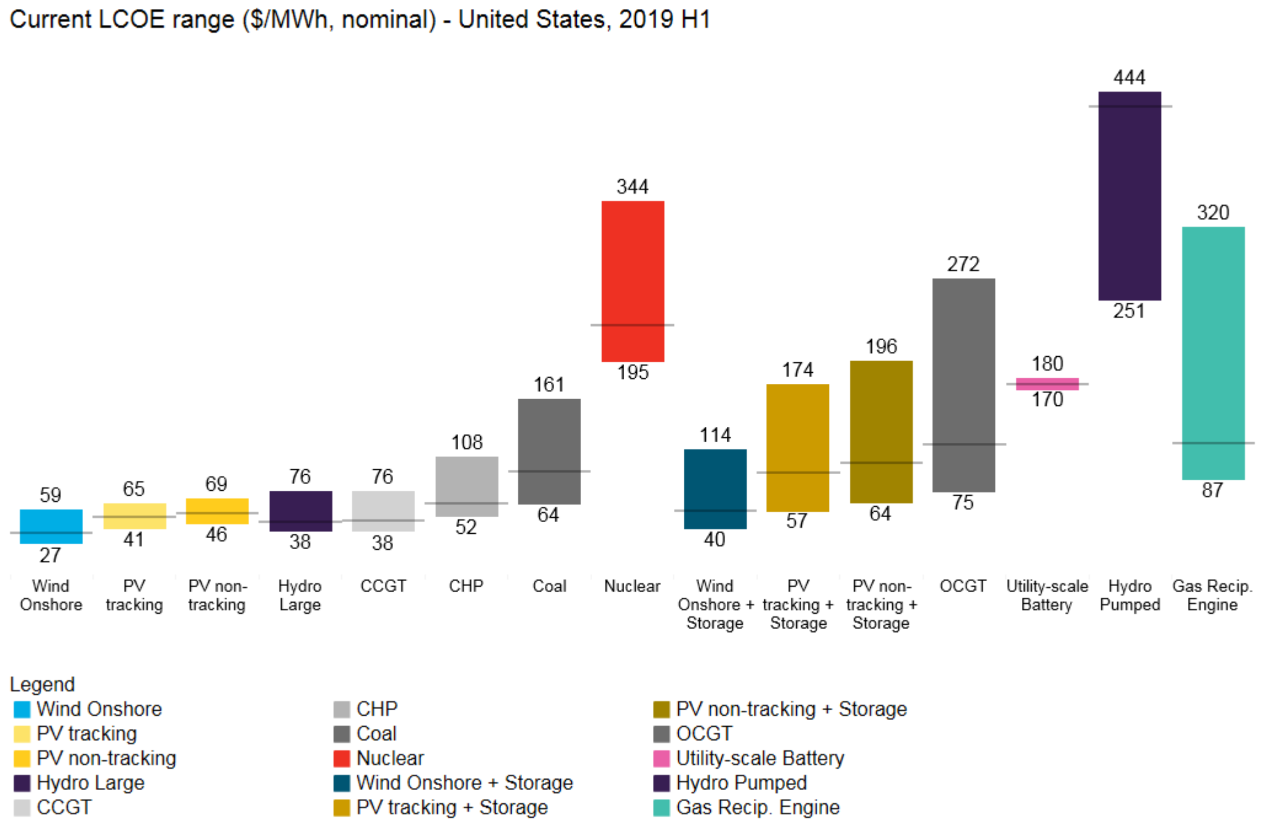
Investing in renewable energy is becoming more and more interesting for corporate bond investors. Renewables are changing the dynamics of many industries and it is creating new industries. Once distressed, traditional utilities like RWE, E.ON and Orsted have transformed themselves into robust companies with stable and predictable cash flows. They used to be highly reliant on fossil-fueled generation with high exposure to volatile European power prices. Now they are more exposed to regulated and subsidized renewables like solar plants and wind farms.

New industries, linked to renewable energy, emerge. A company like Hannon Armstrong facilitates so-called “behind the meter” renewable projects in private homes, businesses and municipalities on a lease basis. Hannon Armstrong taps the corporate bond market for funding for the “behind the meter” projects in shape of rooftop solar panels or energy efficiency improvements.

With more energy produced from renewables, funding for new infrastructure is needed. Today, the Dutch grid operator TenneT BV is building power lines from the North sea to Bavaria making it possible to transport electricity from offshore wind to Bavaria. The project is regulated and will generate a stable and highly visible cash flow. The project is partly funded by a green hybrid bond.

Breakeven costs are dropping rapidly

Until recently, many renewables have relied and benefited from heavy government subsidies. This has led to high cash flow visibility for many renewable projects, which has created great opportunities from a corporate bond investor perspective. Today, however, the game has changed. The breakeven cost for wind and solar power has dropped significantly and for the best projects, the breakeven cost is now below the current power price. Renewables are becoming the cheapest choice for new capacity in most countries. Put differently, renewables are chosen prior to coal, natural gas, fuel oil and nuclear for pure economic reasons. Even more interesting, the cost of solar panels, wind power and lithium batteries seems to continue to decline at a very fast rate making renewables even more attractive going forward.



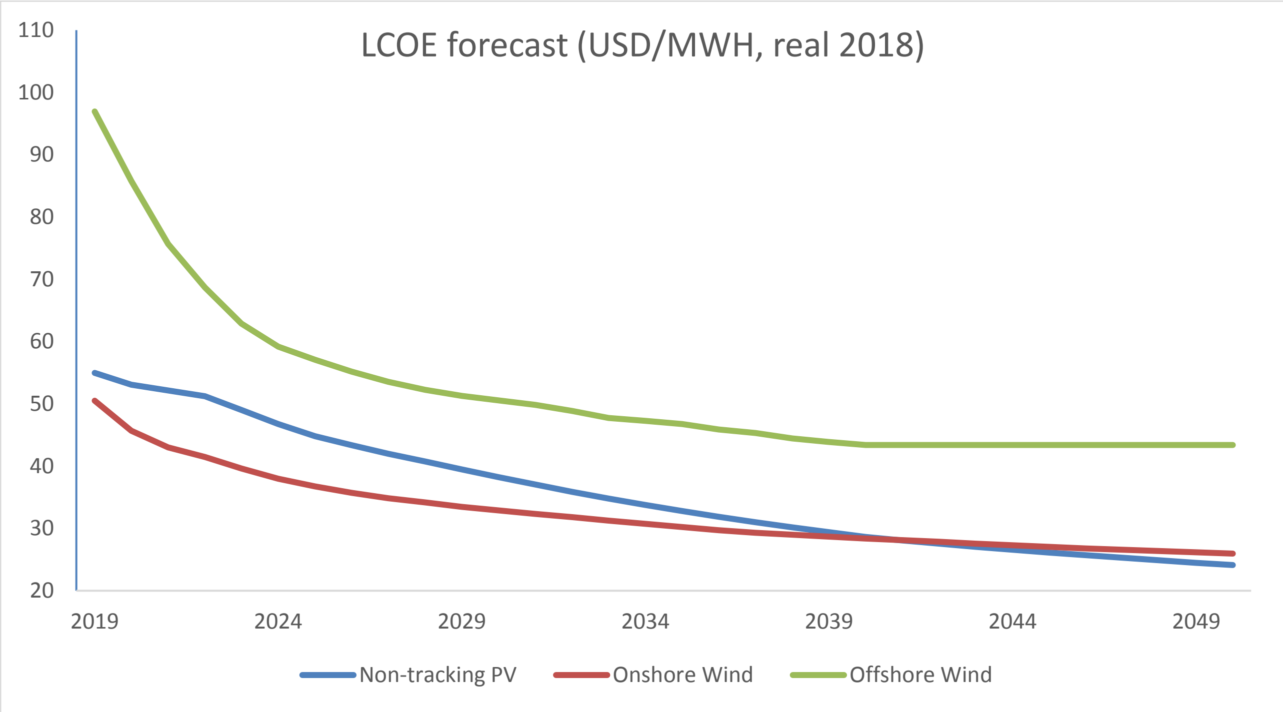
The figure displays the Levelized Cost of Electricity (LCOE) of new capacity in the US. Renewables are, today, the most affordable new assets.

Source: BloombergNEF

Stranded assets

Surprisingly, to many, the biggest reduction in carbon emission in the recent years is coming from the US. The main reason for large reduction in the US is the introduction of fracking, which has produced an abundance of natural gas from shale. This has led to expensive US coal-fired assets being pushed out of the merit order by very cheap natural gas. Much of the coal-fired capacity is now stranded assets, which has led to goal-fired US utilities like Genon defaulting on their corporate bonds – despite Trump's pro-coal campaign.

The marginal cost of wind and solar power is very close to zero. Unlike traditional ways of producing power, the input costs are zero. You get the sun and wind free of charge. Renewables will therefore always be the top pick in the so-called merit order prior to gas, coal and even nuclear power. It will therefore always run at maximum possible capacity. With fixed costs coming down rapidly, the tipping point for pushing natural gas out of the merit order is coming closer. Many of the natural gas fired assets are at risk of ending up sharing the same faith as the stranded coal-firing assets if renewables continue its cost reduction path.



The figure displays the forecasted Levelized Cost of Electricity for solar panels, onshore wind and offshore wind in Germany. Even in a so-called "cold" country like Germany, solar panels are expected to push out fossil fuels.

Source: BloombergNEF

Not a free lunch

However, investing in renewables is not a free lunch, nor is it a "sure thing". In all high growth industries, we see default due to lack of capital or problematic business models. The Spanish renewable infrastructure construction company Abengoa had great success in winning contracts for green energy projects in Emerging Markets, but less successful in acquiring funding and cash flow from the projects despite creative financial engineering. They defaulted in 2016.

Constructing large-scale wind farms are very capital-intensive projects. The decline in government subsidies for wind turbine projects has led to a race to drive the breakeven cost of a wind turbine down. Market leaders like Vestas and Siemens Gamesa are thriving in this environment, whereas smaller players struggle to keep up. The German wind turbine producer Senvion just became the latest victim in the gorilla game of wind turbine production. They defaulted in May. Furthermore, it is vital to be aware of the assumptions made for future projects. Some of the planned offshore projects without any subsidies require a breakeven power price of 50 EUR/Mwh. During the last 5 years, the average baseload German power price has been close to 35 EUR/Mwh, making the offshore projects without subsidies questionable.

It is therefore important not just to buy into hyped green project, but maintain critical sense and look for green companies with a stable cash flow and a robust balance sheet – for pure economic reasons - but with the side effect of lower carbon emission.

The Jyske Corporate Bond strategy is available as individual mandate and as fund in the following Share Classes:

	Jysk Invest High Yield Corporate Bonds CL	**Jyske SICAV High Yield Corporate Bonds EUR IC**	**Jyske SICAV High Yield Corporate Bonds, EUR RD**
ISIN	DK0016262728	LU1529111731	LU1529111814
Currency	EUR	EUR	EUR
Management Fee	0.950 %	0.475 %	0.950 %
Launch date	19.11.2001	01.02.2017	01.02.2017
Approvals	Austria, Germany	Germany	Germany

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