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## INVESTING IN ENERGY HANDBOOK 2012

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# Not simply solar

*Independent private asset manager Capital Dynamics has been busy building out its clean energy and infrastructure direct investment unit, expanding its portfolio beyond the US. Managing directors David Scaysbrook and Rory Quinlan explain the challenges of investing capital in a rapidly changing market*



**Quinlan:** UK best market for clean energy in Europe



**Scaysbrook:** CEI returns can be very attractive and less reliant on subsidies

Two years after its inception, Capital Dynamics' clean energy and infrastructure (CEI) unit has already laid down some significant markers. Over the last 18 months, for example, the team has committed close to \$300 million to energy infrastructure projects. Significantly, it is also now beginning to look beyond its original core focus – on North American solar photo-voltaic (PV) projects – to consider other geographies and energy sources.

Its most recent deal, an investment in three US-based solar projects in March, is typical of its modus operandi to date. It was the team's second investment in US solar this year, following a deal in February to back a similar project in New England.

Capital Dynamics' decision to focus on the US solar market at the outset of its foray into clean energy infrastructure has proved prescient, particularly given the attractive returns on offer in contrast to the challenging times in Europe, says David Scaysbrook, managing director at Capital Dynamics.

"Overall, with the exception of North America, things have cooled somewhat," says Scaysbrook. "We're seeing significant opportunities emerging in sub-sectors of clean energy however. While investment levels overall are down due to what's happening in Europe, there's been an increase in investment volumes for certain niches."

Happily, one of those niches is solar PV. "Solar energy within the overall clean energy industry has been a significant growth market. Wind in the US has been largely stagnant whilst the emergence of shale gas has provided a significant new opportunity for clean energy," Scaysbrook notes.

"Two years ago, we predicted solar PV in the US would be a major investment theme, since then volumes in that sub-sector have leapt to more than \$16 billion per annum

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with corresponding returns underpinning that growth," he adds.

The firm now has a portfolio of more than 60 US solar projects, which are expected to be built and operational within the next 24 months. The team has also secured long-term contracts, a key factor in de-risking cashflows.

## BEYOND SOLAR

Growth in the US solar market is set to continue, Scaysbrook believes. But the way energy is delivered to the consumer will change. "Clean energy is tending towards distributed scale. We're seeing a lot of interest in technologies that sit in the distribution network."

This is where other energy sources step in. "We have noted the emergence of biomass in the US market, and the beginnings of what will be a significant opportunity in gas-fired generation, but for us it will be smaller scale, distributed generation."

One thing beyond doubt is the need for private capital to support the development of new energy infrastructure. "With all the energy market reforms going on in both the UK and North America, gas-fired generation is essentially the fuel that's going to plug the generation gap that's been created by ageing coal-fired plants going out of service, and, in the UK, the lack of a nuclear [replenishment] programme," says fellow managing director Rory Quinlan. »

» Capacity has to come from somewhere, he adds. “The UK government is promoting offshore wind, although we also expect significant gas-fired generation, both distributed and centralised.”

As a result, the Capital Dynamics team is looking beyond solar, a technology that can’t plug the shortfall in capacity on its own.

It has already laid down a marker in the UK with the acquisition in January of a 64-megawatt portfolio of 35 UK landfill gas assets.

The UK is an interesting market, Quinlan notes, primarily because it lags behind its European peers. “Western Europe has been investing strongly in wind energy over the last few years, so many of the countries there are a lot closer to their renewable energy targets than the UK.”

“The UK is the best market for clean energy investment in Europe – and probably second globally behind the US. There will be more solar investment going forward, and that will be geared towards a distributed rather than utility-scale, which suits our model,” says Quinlan.

The UK government has been trying to encourage investment in the country’s energy infrastructure, introducing electricity market reforms in May. “They made clear to everybody the huge sums of capital that will need to be invested in the UK’s energy infrastructure over the next decade, and importantly that the only practical source

of that capital is from the institutional investment community,” says Scaysbrook. “The design of the new regulations is the strongest signal that’s ever come from policy makers encouraging institutional investment.”

### TACKLING VOLATILITY

Volatility has been a problem that has marred the sector in recent years, particularly in continental Europe where goalposts – in the form of subsidy regimes – are continually shifting. It’s something of which the UK government and regulators are acutely aware.

“Some [of the new] measures are designed to reduce revenue volatility, such that pension funds in particular can earn an annuity-style return, without the volatility of the spot-pricing of the electricity market. By removing that volatility they’re appealing to what pension funds need most, which is predictable returns,” Scaysbrook says.

Technology-wise, there will be growth across several different types in the UK, Scaysbrook predicts. “We expect a lot more waste-to-energy, biomass, and onshore wind investment. All three are likely to be popular, particularly with local authority pension funds [investing on a direct basis]. I still think offshore wind is difficult – only the very largest institutional investors can participate in that right now.”

Capital Dynamics’ CEI team is also looking further afield, albeit only in developed countries at this stage. Emerging markets, however, are off the table, at least in the short-term.

“The risk adjusted return opportunities in many emerging markets do not justify the risks, and we therefore continue to look at countries like the US, Canada and the UK, which, in our view, surpass the risk-adjusted returns on offer in India, Thailand

and other emerging markets. We are about to start an investment programme in Australia, for similar reasons to the UK. It’s a carbon-intensive economy, and most importantly, it can afford its planned reforms,” Scaysbrook, a native Australian, notes.

“We’re bullish about the Australian market and the opportunities there over the next five years. Those opportunities will be in coal and methane gas – rather than shale – solar, a little bit of onshore wind, and increased biomass. Most projects are decentralised, and we’re seeing a lot of off-grid opportunities associated with the mining sector.”

The distributed energy model is particularly well suited to Australia given its geographic vastness.

Despite the enthusiasm for the UK and Australia, there’s no escaping the fact that deterioration in global economic conditions has made for a tough dealmaking environment.

“The reduced availability of debt capital has resulted in dampened dealflow in some markets,” Scaysbrook observes. And as the provision of debt has dried up, institutional investors have been forced to look at all-equity structures. But if you can still deliver a 10 to 12 percent unlevered return with no debt, then you really will win favour with LPs, Quinlan notes.

And as the asset class grows, LPs’ awareness of it does too. But there’s still work to be done in educating investors as to the clean energy sector’s merits, Quinlan notes. “LPs are generally sceptical because they see it as an industry underpinned by subsidies. However, as their education increases, they realise this is not the case and that attractive cash yields can be generated without intolerable risk, and accordingly, they are allocating more to the sector,” he says. ■

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## COMPANY PROFILE: CAPITAL DYNAMICS

**Capital Dynamics\* is an independent asset management firm focusing on private assets including private equity, clean energy and infrastructure, and real estate. Capital Dynamics offers investors a range of products and services including funds of funds, direct investments, separate account solutions, and structured private equity products.**

Our senior investment professionals hold an average of over 20 years of investing experience and due diligence expertise, gained through diverse backgrounds as fund investors, direct investors, and co-investors. With 160 professionals and 10 offices worldwide, Capital Dynamics is able to deliver top-quality service to its client base of sophisticated institutional investors such as pension funds, endowments, family offices, high net worth individuals, and advisors.

Headquartered in Switzerland, Capital Dynamics has offices in London, New York, Zurich/Zug, Tokyo, Hong Kong, Silicon Valley, Sao Paulo, Munich, Birmingham (UK) and Brisbane.

#### CAPITAL DYNAMICS CLEAN ENERGY AND INFRASTRUCTURE TEAM

Capital Dynamics' Clean Energy and Infrastructure team comprises senior clean energy industry professionals who have decades of project development, acquisition, financing and operations experience covering a diverse range of proven clean energy technologies from methane recovery, solar and wind energy through to biomass and gas-fired power generation. The team of twelve dedicated professionals have committed investments in over 70 projects across North America and the United Kingdom whilst at Capital Dynamics, providing attractive risk adjusted returns from innovative direct investment strategies in clean energy.

#### FOCUS ON INNOVATION AND QUALITY

Capital Dynamics is an industry leader in quantitative risk management; an essential component of successful private equity

investing. The importance of risk management has intensified due to tighter financial regulations and heightened investor awareness. Our Portfolio and Risk Management team conducts customized, in-depth client portfolio analyses and our Portfolio Servicing team provides comprehensive and dedicated back office services for a diverse set of global investors.

We are proud of our distinguished reputation within the private equity community. In 2011 and 2010, we were voted "Fund of Funds of the Year in Europe" by Private Equity International.

Capital Dynamics is a signatory of the United Nations Principles for Responsible Investment (PRI). Our emphasis on quality has been recognized with the International Standard ISO 9001:2000 certification of compliance.

#### INVESTMENT TYPES<sup>2</sup>

**Primary fund investments** – We have invested in private equity funds since the late 1980s, spanning all geographies and strategies. We have established solid relationships with over 400 General Partners, and monitor 788 active funds.

**Secondary fund investments** – Active in the secondary market since the early 1990s, we raised one of the first dedicated secondary funds. The combination of our large number of existing fund investments and proprietary databases often provides an information advantage when evaluating secondary transactions.

**Direct investments** – Our extensive relationships with the globe's top-tier fund managers provide a consistent volume of high-quality investment opportunities. Our co-investment strategy is focused on

mid-market buyouts, but also includes select development capital and special situations.

**Clean Energy and Infrastructure** – Our specialized team of senior industry investors employs a direct investment strategy focused on a diverse mix of clean and low-carbon energy assets that can offer attractive risk-adjusted returns and compelling diversification benefits from this emerging class of real assets.

**Real Estate** – Members of our Real Estate team have been investing in real estate funds since 1990 and maintain relationships with fund managers around the globe.

#### STRUCTURES

**Funds of funds** – We offer private equity, primary and secondary funds of funds, allowing investors to implement a global allocation strategy through access to premier private equity managers, in addition to portfolio diversification.


**Separate accounts** – We assist clients to create individual programs to meet unique risk profiles and liquidity constraint parameters. We offer legal structuring services to meet the regulatory, tax and compliance requirements for each separate account client.

**Structured products** – We customize solutions one client at a time. Every structured solution is designed to deliver compelling benefits such as early liquidity, enhanced return on investment, reduced risk, lower open commitments and/or decreased risk-weighted capital reserves.

Please contact us at [info@capdyn.com](mailto:info@capdyn.com), or visit our website at [www.capdyn.com](http://www.capdyn.com) for further information.

\* "Capital Dynamics" comprises Capital Dynamics Holding AG and its affiliates

<sup>2</sup> History includes 2005 acquisition of Westport Private Equity Ltd., and the Real Estate team's prior experience



# Performance: the result of long-term dedication

We understand the dynamics of performance and know that long-term dedication to uncompromising quality is the best route to success. Capital Dynamics is an award-winning private asset manager with extensive experience in direct clean energy and infrastructure (CEI), private equity, co-investing, secondaries and real estate.

Our CEI team holds over 100 years of experience in investing, financing, owning and operating conventional and clean energy businesses globally. Capital Dynamics' CEI business was established to address the attractive investment opportunities in this new class of real assets. Please contact us at [info@capdyn.com](mailto:info@capdyn.com).

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