KEYNOTE INTERVIEW

The Australian energy transition story

A generation of nimble and ambitious Australian businesses represents an exciting investment opportunity, say Pacific Equity Partners' Evan Hattersley and Rosie Johnson

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Q Why is Australia an attractive market for private markets investors?

Evan Hattersley: Pacific Equity Partners has been exclusively focused on the Australian and New Zealand markets since 1998, investing through our buyout strategy and, more recently, our Secure Assets Fund. These are well-established markets with a clearly defined rule of law and governance framework. There is also a lot of growth to be found.

In Australia and New Zealand, we are blessed with natural resources, space and a growing population, which underpins a lot of the investment opportunities that we see. These markets also have relatively secure food and energy supplies, which creates a level of security across the broader economy that isn't necessarily the case in other regions around the world right now.

That allows us to look at the growth angles of a business without worrying too much about those basic fundamentals. Finally, we benefit from proximity to the growth markets of Asia.

Q Against that backdrop, where are you seeing the most interesting deals today?

EH: We are seeing lots of opportunities in the energy transition space in particular. There is a real need for nimble companies to help drive that sector, as well as a need for the capital to fund them. The due diligence task is to work out which opportunities are best positioned to succeed in the changing market conditions. It is not a simple thematic investment – there will be winners and losers in the energy transition.

There are three portfolio companies in our debut Secure Assets Fund that are playing into that theme in different ways.

The first is Intellihub, our smart metering business, which installs, owns and operates digital electricity meters across Australia and New Zealand. The company has also created software that manages the data that those meters collect and applies it into the energy retail and wholesale markets. Today, the firm is developing the next generation of software, which will enable more advanced products and services.

Time-of-use data, for example, will enable retailers to offer packages that incentivise consumers to consume less energy at peak times. And, as electric vehicles proliferate, the software will be able to ensure cars charge at opportune times throughout the night, rather than all coming online at 6pm.

The software will also be able to coordinate the charging and discharging of home batteries, managing when solar generation feeds into the grid and when it is cut off at times of excess supply. Intellihub was the first business PEP acquired with our secured asset strategy four years ago, and we recently welcomed Brookfield as a 50 percent shareholder. However, we have retained a 50 percent stake because we see a lot of future upside potential.

Another portfolio company that has recently been exited, WINconnect, is focused on embedded networks, primarily in high-rise towers, as well as shopping centres and airports. Effectively, WINconnect owns all the energy infrastructure in these buildings and manages that network for the residents. It provides a complete suite of utilities, from power and hot water to heating and cooling systems, creating convenience for the householders, while bringing energy transition services into the building. For example, it was one of the first firms to install solar panels across high-rises in Australia, as well as EV charging facilities.

Finally, Zenith Energy provides power generation to mines and remote townships across Australia – areas that are not connected to the grid. It has historically done so using diesel and gas engines, but part of our thesis is to transition to a mix of solar and battery power – alongside traditional fuels – in order to reduce the carbon intensity of those sites.

Q How would you describe the exit environment that Pacific Equity Partners is facing?

Evan Hattersley: Global investors, including sponsors, superannuation funds and pension funds, have been a common exit route for us. We have also seen a number of trade buyers among our recent exits – larger Australian or multinational organisations that are looking to either increase their exposure to sectors where they already participate, or to move into adjacent sectors that are represented by the businesses we own.

It has been a while since we have run an IPO, although this is a path we have been active in using in the past. Right now, public market volatility is high, so we typically find a smoother path to exit with private sales processes, which are proving to be well attended.

The last 18 months has been the busiest that I recall since late-2007 and early-2008, leading into the financial crisis. Of course, the challenge on the buy-side is to work out which of all these opportunities you should be spending your time on, because everyone has limited bandwidth. You need to take that into account as a seller as well, by carefully considering which parties to invite into a process. Very wide auctions tend to turn buyers off, so we aim to be highly selective.

Q How would you describe competitive dynamics, and how do you avoid the most heated situations?

EH: Interest in the energy transition has been incredibly strong globally, especially as we have come out of covid, and Australia is no exception. As a consequence, competition for well run, scaled assets is very high. Although a lot of the big global investors have a presence in the region and are actively participating in the market, what we look to do is invest in businesses that are a little below the radar of those firms. They may be earlier in their life cycle and perhaps require a more operationally intensive approach in order to reach their full potential.

Q How do you approach ESG risk as a firm?

Rosie Johnson: We incorporate ESG risk considerations very early on, and we consider them in terms of overall materiality to the business. These thresholds are evolving as ESG evolves. For example, coal-related assets and infrastructure were investments we would have been comfortable with a decade ago, and would even have been considered to have strong tailwinds. Today, these are assets we wouldn't touch, possibly even at a second-degree level.

The shift in public sentiment around climate change means there is greater sensitivity among our own team and our investors. There are also greater exit risks, which can have a material impact on the investment. We expect future owners and the market to downgrade valuations for businesses that have not progressed their ESG agendas or have not incorporated ESG into their strategies.

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>
> EVAN HATTERSLEY

Q Do you see ESG as a value creation tool?

RJ: Absolutely, and we want to help businesses identify the key ESG themes that can create value and prepare them for a more decarbonised, socially conscious and diverse future. To that end, we ensure ESG is integrated throughout the investment life cycle, starting with deal sourcing. In our very earliest discussions about a target, we are looking for what could really move the needle in terms of performance from an ESG perspective, and what could hold the business back.

Then, during the stewardship phase, we fold these businesses into the PEP world of ESG in terms of the data we collect and the way we report that data to our investors. At the same time, we are working with our businesses to execute their ESG strategies. For example, with Intellihub, it was decided that the most meaningful impact the company could have on the decarbonisation of the economy was to accelerate its rollout of smart meters; setting more ambitious targets and finding the most effective way to accelerate the rollout of smart meters therefore became a priority. Of course, that also fed directly into the business's bottom line.

With Zenith Energy, as Evan said, the ambition was to roll out more renewable energy, retrofitting existing operations with solar. Again, that is not only benefitting the planet, but also making the business more valuable as a whole.

ESG is evolving into more than simply a compliance exercise. From decarbonisation and electrification to diversity and supply chain management, there are opportunities to innovate business models and build businesses that are better placed to exist through the transition.

Q Beyond ESG, how are you typically looking to add value to the assets you own?

EH: We always have a clear investment thesis as we enter deals – a strategic plan designed to allow a company to double its earning profile during our period of ownership. In order to reach that goal, we set ambitious but achievable targets. We also make sure that the right executive team is in place to deliver on those plans, and that they are aligned with us as shareholders. Both financial and ESG outcomes are part of those incentivisation plans.

In addition, we ensure the team has the capital it needs to achieve those ambitions. That refers both to the equity from our funds and the credit facilities that allow the company to grow in a cost-effective manner, without being hamstrung by onerous debt covenants.

Finally, we ensure the companies have the time they need to execute on the strategy. We are not setting out to maximise next quarter's earnings, or even next year's. We have a five-to-seven-year time frame in which to build businesses in a sustainable manner.

Q What do you believe the future holds for the Australian market?

EH: I am very bullish on the long-term outlook for Australia. I believe net immigration will once again pick up as covid restrictions ease, and I think the fundamentals of our economy remain in good shape. The covid situation here has proved challenging for a lot of people, but not in a way that has caused too much long-term distress to households or the broader market.

Of course, the changing macroeconomic environment is something we need to keep an eye on. But we are looking to make a real step change in earnings in the companies we back, and so our performance is not contingent on a few points of inflation. I firmly believe, therefore, that a wealth of strong Australian investment opportunities lies before us. ■

Evan Hattersley is managing director and Rosie Johnson is director of ESG at Pacific Equity Partners