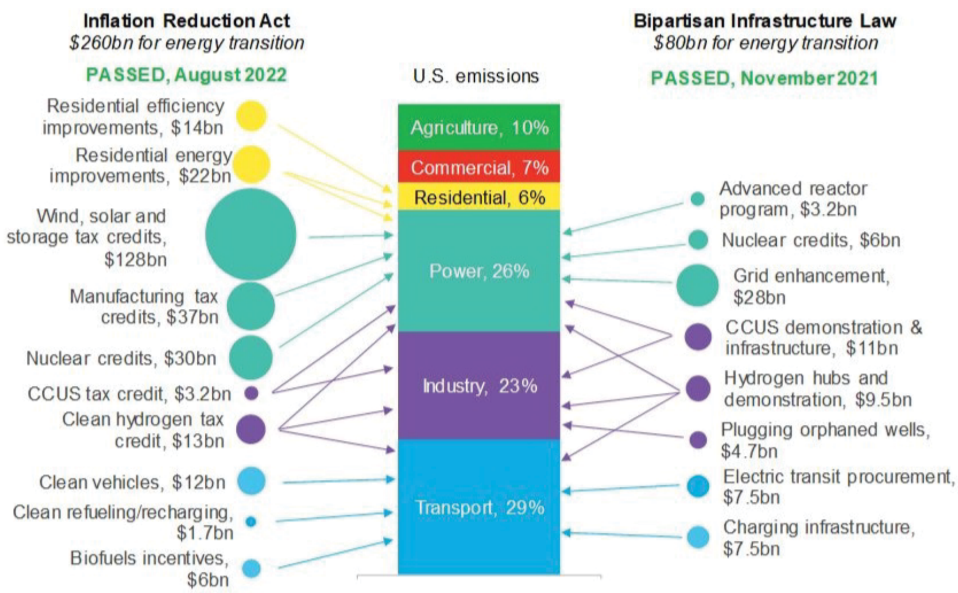
A Game Changer for Clean Energy

Fund in focus: Brompton Sustainable Real Assets Dividend ETF (BREA), Sustainable Power and Infrastructure Split Corp. (PWI)

On August 16, 2022, President Biden signed the Inflation Reduction Act (IRA) into law, which consists of US$370 billion of support for renewable energy and climate related spending over the coming decade. The passing of the IRA acts to bring President Biden closer to achieving his goal of halving the United States' CO2 emissions by 2030 (vs 2005 levels) and reaching his Net Zero emission objective by 2050. In this Insights, we break down details of the IRA and provide an assessment of this bill's implication for various sectors.

Approximately US$260 billion of the US$370 billion comes in the form of tax credits to incentivize investment in renewable energy and low emission fuels. A detailed breakdown can be found in the diagram below.

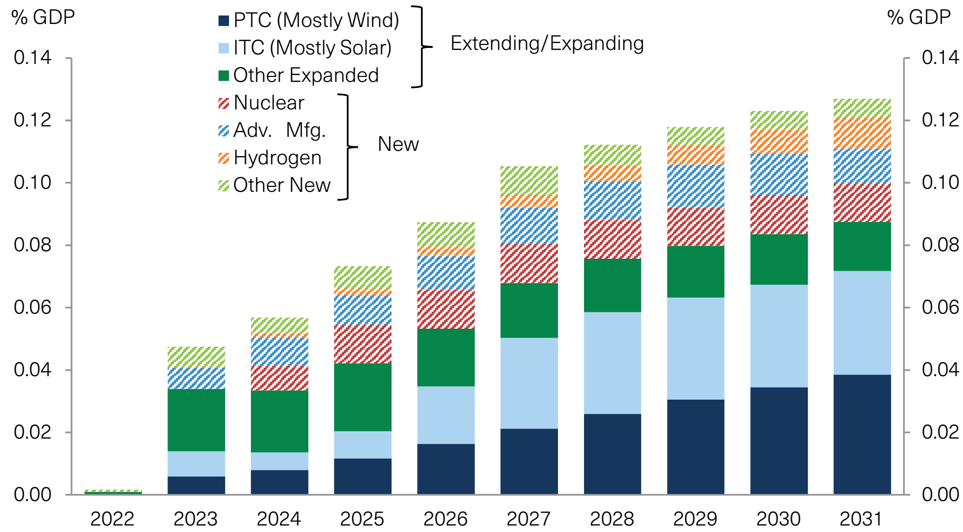


Source: BloombergNEF as of August 18, 2022

These tax credits cover a wide span of the renewable energy generation mix, including wind, solar, fuel cells, carbon capture and sequestration, biofuels, green and blue hydrogen as well as nuclear power.

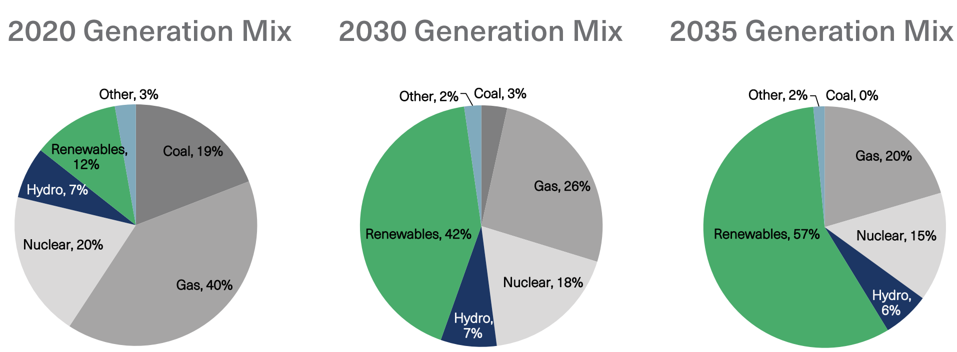
The chart below breaks down new credits versus extended credits for each category of renewable energy in terms of % of GDP. Investment Tax Credits (ITC) and Production Tax Credits (PTC) make up a significant share of total spending inside this package. We believe the extension of ITC and PTC will act to attract new capital to enter the solar and wind power space. Currently, solar and onshore wind power are already cost competitive versus traditional fossil fuel. We believe the introduction of the new energy storage credit is the most transformative for the renewables industry, as it incentivises developers to build storage sites at their wind and solar generation facilities. Intermittency has always been the pain point for renewables, and the energy storage credit is the missing piece of the puzzle to either partially or fully address the reliability issue of solar and wind power.

We also believe the new tax credits for nuclear power will act to improve the cash flow stability of nuclear operators, especially those operating in unregulated states. Further, we estimate that the clean hydrogen PTC will significantly improve the economics of green hydrogen (the most environmentally friendly source of hydrogen), bringing it to cost parity with grey and blue hydrogen (which are incrementally less environmentally friendly to produce).



Source: Congressional Budget Office, Joint Committee on Taxation, Goldman Sachs as of August 17, 2022

According to Morgan Stanley, renewables generation is expected to make up 42% of the U.S. generation mix by 2030, up from only 12% in 2020 (see chart below). Coal generation is expected to decline from 19% to 3% in 2030. This shift in generation mix towards renewables will be a significant tailwind for companies both up and down the renewable energy supply chain, expanding our revenue forecasts for upstream suppliers such as wind turbine manufacturers, solar panel manufacturers, especially those domiciled in the U.S, and electric utilities companies with renewable generation or transportation capacity. Companies in the energy infrastructure space also see their opportunity set expand as their hydrogen and transmission potentials are currently being under appreciated. from the shift towards EVs. Furthermore, EV related industries like all EV manufacturers and battery manufacturers as well as domestic service providers will also benefit from the shift towards EVs.



Source: Energy Information Administration, S&P Capital IQ, BloombergNEF, Morgan Stanley as of August 18, 2022

Currently, residential and commercial emissions make up 13% of U.S. total emissions. The IRA addresses this by providing support for energy efficiency and decarbonization through increased credits for energy efficient home improvement for residents, credits for energy efficient commercial buildings, credits for clean vehicles and increased incentive to businesses for building alternative fuel charging stations. This will greatly benefit companies in the HVAC space and building systems solutions players in the Industrials sector, especially those that are providing energy saving solutions to their customers.

Since the announcement of the IRA on July 27, 2022, clean energy stocks have already outperformed other segments of the market[1]. Goldman Sachs estimates green capex needs to increase by US$1.8 trillion annually (from US$1.2 trillion annually from 2016-2020) in the next 3 decades in order to meet US's 2050 Net Zero objective. Is the IRA alone sufficient for the U.S to achieve its Net Zero target? No. But is it a big deal? Undoubtedly so. The IRA provides unprecedented support for renewable energy and signals to the market that the U.S. is willing to take the necessary steps towards achieving that goal. The IRA spans over the course of a decade, which we believe will already meaningfully expand the opportunity set for clean energy companies. Companies in the Renewables, Electric Vehicles and Industrials space are well positioned to generate greater returns and cash flows than in the previous decade.

Brompton's Approach

Brompton Sustainable Real Assets Dividend ETF (BREA) and Sustainable Power & Infrastructure Split Corp. (PWI) invest in renewable and energy efficiency related companies that are leaders in the renewable energy transition space. Their scale and leadership positions allow them to generate superior returns vs their peers in an inflationary environment. We prefer to invest in leading innovators in the Utilities and Industrials space with high visibility into future cash flow generation capabilities. We believe this strategy provides better risk-adjusted returns, particularly in an uncertain macro environment.

[1]As of Aug 26, 2022. Source: Goldman Sachs Equity Research August 30, 2022.

BROMPTON FUNDS

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