

## European Renewable Energy Sector - Headed for Leadership?

In the COVID-19 induced chaos and disarray, numerous industries have been hit even harder than others. The energy sector in particular looks certain to undergo a severe, general transformation. Throughout this year the energy sector's indexes in the US and Europe (S&P 500 energy and MSCI Europe energy) went down 44.2% and 51.6% YTD respectively. Incumbent oil majors, including BP, Royal Dutch Shell, and Equinor, are facing strategic dilemmas on whether shifting their focus and riding the new green wave. The rationale is clear: while they were struggling, the renewable energy indexes comfortably outperformed the market in impressive fashion. Indeed, the S&P global clean energy index recorded a staggering +83.5% return YTD. Yet, these energy giants of the past are already years behind. Investors are shifting their attention to new clean companies focused exclusively on clean energy production, such as Iberdrola, Enel, and Orsted. Not by mistake, they have been dubbed the “new energy majors”.

The renewable energy sector has been on a steady ascent, attracting over €1,290bn of new investment worldwide from 2014 to 2019. The capital spent on clean energy is slowly approaching the figures allocated to oil and gas investments, which amounted to a little over €400bn in 2019 (versus 260bn for renewables). According to the International Energy Agency (IEA), starting from 2020, 90% of new electricity generation will come from renewable sources, whereas coal energy production is predicted to shrink by as much as 15% over the next 5 years. Consequently, green electricity is projected to surpass coal-generated counterparts as early as 2025. It will mark a strategic shift in the energy industry, dominated by coal for the last 50 years.

Hence, it should not be a surprise that the pandemic has accelerated the process even more profoundly. Stringent lockdowns which drastically reduced the oil demand have pushed its price down by more than 30% compared to the last year. Especially in Europe, which currently experiences the second wave of coronavirus, the discussions about transforming the continent into a bedrock of clean energy production have proliferated. Out of the €750bn coronavirus recovery fund agreed by the European Commission, €240bn is to be directed at shoring up investment in renewable energy. The policy will inevitably favor the already clean players such as Iberdrola, Enel, or Orsted – already the three biggest European utilities gauged by market capitalisation in Q3 2020. Dubbed the “new energy majors”, they are well prepared for the upcoming changes in the industry.

### Iberdrola

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The dissection of the European renewable energy market indicates one extremely potent company – Iberdrola. The Spanish utility's (BME: IBE) market valuation increased by 8.1% from Q3 2019 to 2020 and currently stands at €3.1 bn. It makes the business the second largest European utility by market value, just behind Italy's Enel.

Iberdrola is a remarkable success story. Back in 2001, when Ignacio Galan, its current CEO and chairman, took over, the vision encompassing relying solely on renewable energy raised eyebrows. But the risky move seems to be paying off. Through the business model of building its infrastructure (solar, wind, and hydrogen in particular) and being proactive in the M&A market, the Spanish giant recorded a healthy net profit of €3.4bn.

Iberdrola has aided its turnaround from a non-renewable producer through a strategy of “friendly acquisitions”. Its high activity on the M&A market has not gone unnoticed. Its recent acquisition of PNM Resources, an American utility, for \$8.3bn, has placed its North American among the top three renewable operators on the continent. The move indicates Iberdrola's continuously high hopes of becoming a major player not only in its domestic market but also in international ones. Currently, only 40% of its revenue is generated in Spain – in 2001 the figure stood at 90%.

For Iberdrola, the coronavirus induced economic turbulence could turn out highly beneficial. The disruption experienced by the traditional European oil majors, including BP or Royal Dutch Shell, poses a strategic opportunity for the company, as well as the whole renewable energy sector. The shift is already happening – on the 5th of November Iberdrola increased its pledge to invest €10bn in developing production capacity to €75bn. The planned investment would almost double its clean energy capacity to 60GW in 2025. It is worth underscoring the fact that 85% of the sum will be used on both European and US projects, signaling the company's aspirations to become a truly global player.

## Orsted

Orsted is a Danish multinational power company and the world's largest producer of offshore wind power with a 16% market share. The company was founded in 1972 as DONG, an acronym for Dansk Olie og Naturgas, but in 2017, after having sold its oil and gas business to Ineos for \$1.05 bn, it changed its name to Orsted in honor of Danish scientist Hans Christian Orsted.

Two days ago, Orsted and BP agreed to develop a large-scale renewable hydrogen project in BP's Lingen Refinery in north-west Germany. The project consists of producing hydrogen via the electrolysis of water with the use of electricity generated from renewable sources like wind and solar. Orsted said that the electrolyser at the Lingen refinery will be powered by one of its offshore wind farms in the North Sea. Replacing the currently used

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fossil-based hydrogen with the so-called green hydrogen produced from renewable energy can help plants such as the one in Lingen to dramatically reduce their CO2 footprint.

Where Orsted has led, others follow. Indeed, several major companies are now aiming to make the same transition the Danish company did. For example, in 2017, the Norwegian oil giant Equinor began operations on the world's first floating wind farm near the coast of Scotland. The turbine technology implemented is well beyond that of conventional turbines, opening vast deepwater areas to power development.

## Conclusion

Despite looming economic uncertainties, the investor appetite for renewables has remained strong. Indeed, the shares of publicly listed renewable equipment manufacturers have been outperforming some of the major stock market indices thanks to solid finances and strong business growth expectations over the medium term.

Moreover, renewable capacity additions are on track for a record expansion of nearly 10% in 2021. Two factors should drive the acceleration, leading to the fastest growth since 2015. First, the commissioning of delayed projects in markets where construction and supply chains were disrupted. Prompt government measures in key markets – the United States, India and some European countries – have authorised developers to complete projects several months after policy or auction deadlines that originally fell at the end of 2020. Second, growth is set to continue in 2021 in some markets – such as the United States, the Middle East and Latin America – where the pre-Covid project pipeline was robust thanks to continued cost declines and uninterrupted policy support.

TAGS: Renewables, Energy, Oil & Gas, Iberdrola, Orsted, Sustainability

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