NextEnergy Solar Fund

Investment companies | Update | 16 January 2025

Well covered, growing, double-digit yield

Despite having many attractive features, NextEnergy Solar Fund (NESF) has seen its share price derate significantly during the last two years (driven largely by macroeconomic headwinds, such as the impact of higher interest rates on income-producing assets, which has affected the whole renewable energy sector and has been a factor again very recently). A hefty and, in our view irrational, discount to net asset value (NAV) has opened up, bringing with it significant yield expansion – NESF now has the second-highest dividend yield in the FTSE 350 – despite its dividend being 1.3x cash-covered during its financial year ended 31 March 2024 (FY2024), with a coverage target of 1.1x – 1.3x for the year ending 31 March 2025 (FY2025) on a higher target dividend.

NESF has been making progress with its capital recycling programme (a strategy that involves selling assets and reinvesting the proceeds into higher-returning opportunities) (see page 8), with the proceeds used to reduce debt and fund share repurchases that, at current discount to NAV levels, are very NAV-accretive. The final phase for 100MW of assets could prove transformational.

Income from solar-focused portfolio

NESF aims to provide its shareholders with attractive risk-adjusted returns, principally in the form of regular dividends, by investing in a diversified portfolio of primarily UK-based solar energy infrastructure and complementary energy storage assets. Since its initial public offering (IPO), NESF has paid £370m of ordinary dividends – roughly its market cap – highlighting its strength as a total return play.

Sector	Renewable energy infrastructure
Ticker	NESF LN
Base currency	GBP
Price	63.90p
NAV[1]	98.12p
Premium/(discount)	(34.9%)
Yield	13.1%

Note 1) Morningstar estimate as at 15 January 2025. Last published NAV is 101.3p as at 30 June 2024.

NextEnergy Capital is the largest specialist solar manager, with c$4.4bn of solar assets

One of NESF's key attractions is the size of its yield

The investment in NextPower III ESG gave NESF instant international diversification

QuotedData
BY MARTEN & CO

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Domicile	Guernsey
Inception date	25 April 2014
Manager	NextEnergy Capital IM
Market cap	370.6m
Shares outstanding (exc. treasury shares)	580.0m shares
Daily vol. (1-yr. avg.)	1.659m shares
Net gearing[1]	30.2%

Note 1) Net gearing is at 30 September 2024 and is excluding preference shares.

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At a glance

Share price and discount

There has been a clear impact on NESF's discount, which has widened in response to rising interest rates. Recent figures have shown inflation, while much reduced over the last couple of years, to be more stubborn than was expected even in the middle of last year. This has, at the margin, extended the higher interest rates for longer narrative, which has weighed on the discounts of all of the renewable energy funds, NESF included – leaving them all close to or at long-term discount highs.

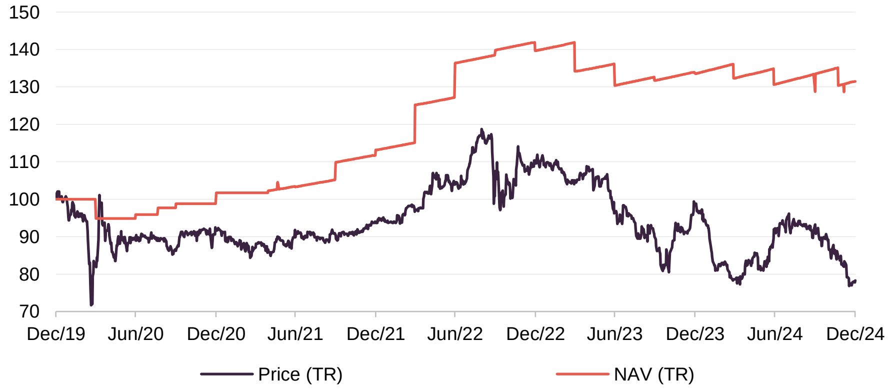
Time period 31 December 2019 to 15 January 2025

Source: Morningstar, Marten & Co

Performance over five years

The end-September NAV was 97.8p – down from 101.3p as at the end of June, 107.3p at end March 2024 and 107.7p as at end December 2023. On the positive side, time value, the sale of Whitecross, share buybacks and the revaluation of NextPower III added 7.7p, 0.6p, 0.2p and 0.1p respectively. NESF's weighted average discount rate stands at 8.1%, having moved up by 0.1% for 31 March 2024 valuation.

Time period 31 December 2019 to 31 December 2024



Source: Morningstar, Marten & Co

Year ended	Share price total return (%)	NAV total return (%)	Earnings per share[1] (pence)	Dividend per share (pence)	Cash dividend cover (x)
31/03/2021	4.9	7.2	6.32	7.05	1.1
31/03/2022	11.4	23.1	17.34	7.16	1.2
31/03/2023	8.2	7.2	7.55	7.52	1.4
31/03/2024	(25.1)	(1.4)	(1.42)	8.35	1.3
31/03/2025				*8.43*[2]	*1.1-1.3*[3]

Source: Morningstar, Marten & Co. Note 1) Fully diluted. 2) Target dividend for FY2025. 3) Forecast cash coverage of target dividend as per the company's announcement on 15 May 2024.

Portfolio update

Spanish and Portuguese co-investments energised

NESF has invested $50m in NextPower III ESG – a private solar infrastructure fund that owns international solar assets – that targets gross IRR between 13 and 15% on its investments. This is significantly above the level that UK solar funds are offering.

Shortly after we last published, NESF announced that its first two international solar co-investments, in which it invested alongside NextPower III ESG, had been energised. The assets are a 210MW solar project in Portugal (Santarém) and a 50MW solar asset in Cadiz, Spain (Agenor). NESF directly owns 13.6% of Santarém, 24.5% of Agenor, and 6.21% of NPIII ESG. Both assets have long-term PPAs (power purchase agreements) with Statkraft (Santarém's PPA is the largest in Portugal's history).

NESF's manger highlights that the investment in NextPower III ESG gave NESF instant international diversification (the fund owns development-stage and operational assets in OECD countries), removing the need for NESF to have its own teams on the ground around the world. NextPower III ESG now has 102 operating assets, and the co-investment opportunities that NESF is able to access have the additional benefits of no management fee and no carried interest (carry). This is a differentiating factor for NESF versus its peers.

Battery storage

Camilla 50MW standalone battery project online

Since we last published, NESF has brought Camilla, its first standalone battery project, online. This is also the first project from its JV (joint venture) with Eelpower (the joint venture is 70% owned by NESF and 30% by EelPower). The 50-MW lithium-ion BESS (battery energy storage systems) asset, located in Edinburgh, is a one-hour battery, but has been pre-augmented for two hours so any upgrade to this should be plug-and-play. BESS assets have a very different revenue stack to solar, and this asset is very complimentary to NESF's existing portfolio (BESS asset revenues are much volatile but can be much higher than those from solar, which is very stable). With its investment in NextPower III, NESF has exposure to 1.8GW of batteries. NESF's manager highlights that it is the only renewable generator that has a utility scale battery online at present and that this is approaching its one-year operating anniversary in March 2025.

Capital recycling programme

Two out of five assets sold at a premium, adding 1.84pps to the NAV.

NESF has sold three of the five assets – Hatherden (November 2023), Whitecross (June 2024) and Staughton (November 2024) – earmarked for its capital recycling programme. These were all at premiums to their carrying values in the NAV, adding 2.76p cumulatively to the NAV. The three sales have raised £72.5m, of which £38.8m has been deployed to pay down NESF's revolving credit facilities (RCFs), with c £4m used to repurchase shares (see page 8). However, NESF plans to look at alternative uses for the proceeds (for example, NAV-accretive investments) as the discount narrows.

Prior to the sale of all of these assets, NESF had added considerable value to both through its initiatives. For example, at Hatherden, approval for co-locating battery storage on the site was achieved, while an AR4 contract (Contracts for Difference contracts issued in the fourth round of the UK government's CfD scheme) was secured for Whitecross. It adds that the latter had a very small snag list, so was very easy to sell.

NESF's manager marketed the five assets as a portfolio but received more interest for the assets individually.

NESF's manager says that it is taking its time with the disposal of the remaining two assets, which will be sold together in phase IV (the final phase), and exclusive negotiations are continuing with third-party bidders. It adds that it is seeing many pricing points in the market that are proving NESF's NAV and there are superior valuations in the secondary market, versus the listed space, which in its view is being over-cautious.

Gearing (borrowing) – very attractive long-term preference shares

Paying down floating rate debt

As at end September 2024, NESF had £333.3m of debt of which £156.4m was long-term debt at fixed rates. It also had £198.4m of long-term preference shares. Total gearing was 48.2% of GAV including the preference shares (the limit is 50%) and 29.1% excluding them. The weighted average cost of debt (the total interest paid on a company's debt, weighted by the size of each debt) instrument was 4.9% including the preference shares. As noted on page 4, the bulk of the proceeds of the capital recycling programme have been used to reduce NESF's floating rate debt and, while this is the more expensive of NESF's debt sources, the financing provided by the RCFs is still very competitive at SONIA + 1.2%–1.5%, reflecting NESF's scale and creditworthiness. Both RCFs were refinanced in March and April this year on existing terms or better.

The preference shares remain an attractive source of finance in the current environment. While they have an indefinite life, they can be redeemed at par or converted to equity in 2036 and there could be significant upside from this (the managers describe it as a great form of non-amortising debt). NESF has been amortising long-term debt across the remaining life of its subsidiaries.

ESG, including sustainability and biodiversity

NESF is an Article 9 fund

As a reminder, NESF is an Article 9 fund under EU SFDR and Taxonomy (these are funds that specifically target sustainable objectives, such as environmental or social benefits, ensuring all their investments align with these goals). During the year ended 31 March 2024, its renewable generation had avoided the production of 279.3 ktCO_2e. As we have previously highlighted, if the UK is to meet its net zero targets, much more needs to be done and NESF is keen to play its part in this. Its manager, NextEnergy Capital is the largest specialist solar manager, managing c$4.4bn of solar assets across its key OECD target markets, and aims to be at the forefront of developments in the space. Ross Grier (chief operating officer and head of UK investments at NextEnergy Capital) sits on the UK government's Solar Taskforce, which was established to drive forward the actions needed to meet the government's ambition to achieve clean power by 2030.

NESF published its third standalone sustainability and ESG report – click here.

In June 2024, NESF published its third standalone sustainability and environmental, social and governance (ESG) report, which you can read here (also click here for the 2023 report). NESF is keen to highlight its commitment to biodiversity and 81% of its portfolio assets have enhanced biodiversity measures. New habitat provisions comprise 27 bat boxes, 35 beehives, 78 bird boxes, 131 bug hotels, 32 hibernacula, 35 kestrel boxes, six owl boxes and 1,246 shrubs planted. NESF also provided community funding of £106k and donated £339k to the NextEnergy Foundation in cash and solar modules during the last financial year.

NESF published its first nature strategy report in November 2024. Key elements set out in the report include: an SBTN-aligned commitment (a commitment to reduce its negative impact on nature and contribute to its conservation) to prevent the material loss of natural ecosystems in direct operations and supply chains; a responsible land use target including nature implementation plans and dual land use regimes; a nature restoration target to restore natural ecosystems in the regions where NESF operates that need support; and updated nature-related risk management procedures for supply chain transparency and sustainability.

Performance

The end-September NAV was 97.8p – down from 101.3p as at the end of June, 107.3p at end March 2024 and 107.7p as at end December 2023. The main negative drivers between end-June and end-September were lower than budgeted generation due to lower-than-expected solar irradiation (-2.1p) and changes in power prices forecasts (-3.0p), with changes in short-term inflation costing an additional 0.1p. On the positive side, time value, the sale of Whitecross, share buybacks and the revaluation of NextPower III added 7.7p, 0.6p, 0.2p and 0.1p respectively.

The main negative drivers of the reduction between end-March and end-June were lower than budgeted for generation due to lower-than-expected solar irradiation (-1.7p) and changes in power prices forecasts (-1.2p), although changes in short-term inflation added 0.4p and the revaluation of NextPower III added 0.1p.

The main negative drivers of the reduction between end-December and end-March were changes in power prices forecasts (-2.7p – mainly due to lower commodity prices – particularly gas, which sets the marginal price of electricity – which was down by around 30-40%, influenced by above-average gas storage levels, milder weather across winter 2023/24 and sustained reductions in demand) and lower than budgeted for generation (-1.7p). Furthermore, although changes in short-term inflation added 0.3p, the revaluation of new assets added 1.6p and the revaluation of NextPower III added 0.7p.

Weighted average discount rate is 8.0%.

NESF did not make any changes to its discount rate assumptions for the quarters ended either 31 March 2024, 30 June 2024 or 30 September 2024. On 21 November 2024, NESF said that, for the quarter ended 30 September 2024, it had:

1. updated its inflation assumptions to reflect the latest-available third-party inflation data from HM Treasury Forecasts and long-term implied rates from the Bank of England for its UK assets; and
2. updated its power price forecasts capturing the latest-available third-party adviser long-term power curves.

NESF made the same statements for the previous two quarters, but, for the end-March valuation it also said that it had introduced new discount rate assumptions for its new 50MW operating energy storage asset, Camilla, which were in line with energy storage investment company peers. This increased NESF's weighted average discount rate at 31 March 2024 slightly to 8.1% (31 December 2023: 8.0%), and it has remained at the level for the end-June and end-September valuations.

Potential upside in power curve assumptions

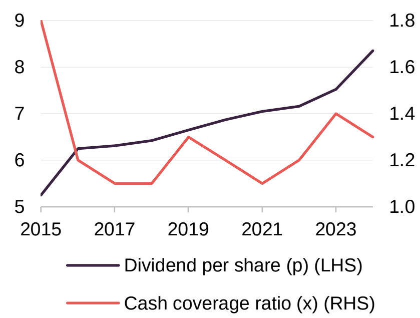
NESF uses a weighted average of the prices from three power forecasters in arriving at its own power price assumption. However, the manager believes that there is considerable upside that is not factored into these, for the following reasons:

1. the power price forecasts assume that cheap nuclear generation comes in on time and on-budget, which feels unrealistic given the history of large-scale infrastructure projects in the UK, particularly nuclear;
2. the assumptions do not fully capture the impact of the electric action of heating and roll-out of electric vehicles (EVs) in the manager's view; and
3. there is now allowance for shocks to the system; for example, events such as the invasion of Ukraine, which overall tend to impact power prices positively from a generator's perspective, factored in.

The manager says the situation is actually quite exciting and not as doom-and-gloom as the predictions suggest.

Dividend – second highest yield in the FTSE 350 Index

Figure 1: Dividend and cover[1,2]



Source: NextEnergy Solar Fund. Note: 1) For financial years ended 31 March. 2) Cash dividend cover is pre scrip dividends.

NESF has 10 years history of paying a growing cash-covered dividend (dividends fully supported by cash income). For the year ended 31 March 2024, NESF paid a total dividend of 8.35p per share, which is a yield of 13.1% on its share price of 63.9p as at 15 January 2025. This is the second-highest yield in the FTSE 350 Index (the highest, Ithaca Energy, is artificially inflated and uncovered, as it is honouring a pre-IPO commitment to distribute US$400m of dividends for its 2023 financial year).

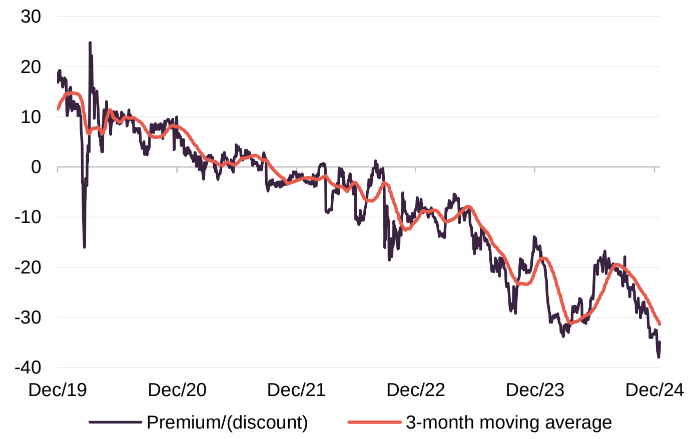
NESF has about 150m retail investors on its share register (around 26% of the total) and its board is acutely aware of the importance of income to these investors. NESF's board sets a target for the year (usually announced in November as part of the interim accounts) which considers five-year forecasts of revenues and costs and allows for a sensible progression of the dividend over time that is both covered and sustainable. The target for the year 31 March 2025 is 8.43p per share, with forecast coverage of 1.1x-1.3x. The first and second quarterly interim dividends of 2.1p per share were paid on 30 September 2024 and 31 December 2024 respectively. Dividend cover for the first half was 1.5x.

Share price discount to NAV

The impact of the shifting sentiment on UK interest rates on NESF's discount remains an obvious feature of Figure 2. Recent figures have shown inflation, while much reduced over the last couple of years, to be more stubborn than was expected even in the middle of last year. This has, at the margin, extended the higher interest rates for longer narrative, which has weighed on the discounts to NAV of all of the renewable energy funds, NESF included – leaving them all close to or at long-term discount highs.

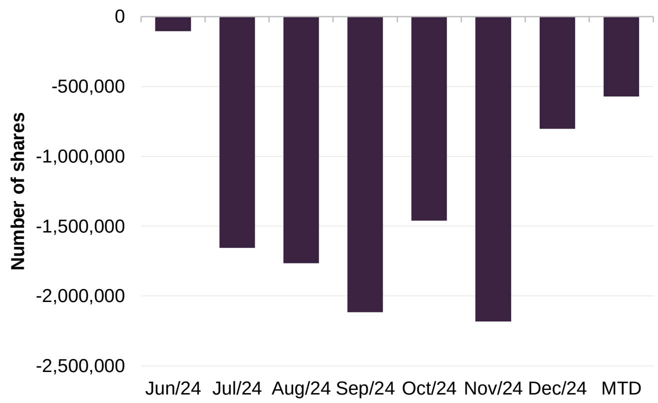
As is illustrated in Figure 2, NESF's discount remains very wide relative to its own history, offering significant narrowing potential, when interest rates retreat (something we started to see when inflation fell previously) and share repurchases continue. We also see potential for NAV growth through NESF's capital recycling initiative. However, we still think that one of NESF's key attractions is the size of its dividend yield, which is covered and supported by its attractive terms on its preference shares debt. We also see potential upside from the resolution of the cost disclosure issues that have plagued the sector, which should hopefully stem selling by professional investors.

Figure 2: NESF premium/(discount) to NAV



Source: Morningstar, Marten & Co

Figure 3: Share net issuance/repurchases



Source: NextEnergy Solar Fund, Marten & Co

£20m share buyback programme

NESF has been very active, repurchasing a modest amount of shares most days.

On 18 June 2024, NESF announced that it was launching a £20m share buyback programme designed to help narrow the discount to NAV. As is illustrated in Figure 3, since the programme's launch, NESF has been very active in repurchasing its own shares, buying back 10.9m shares, equivalent to 1.8% of its issued share capital. These purchases are strongly NAV-accretive, given the prevailing discount. All of the repurchased shares are held in treasury.

Board update

Board completely refreshed as 10-year anniversary passed.

Since we last published, Caroline Chan has been appointed as chair of the management engagement committee and Jo Peacegood has been appointed as chair of the audit committee, following the retirement of Patrick Firth (who had served his full nine-year tenure). The chairwoman, Helen Mahy, was previously the chair of TRIG and Paul Le Page is ex-Bluefield. Both joined the board in 2023.

Previous publications

Figure 4: QuotedData's previously published notes on NESF

Title	Note type	Date
Climbing inflation and power prices driving NAV uplift	Initiation	9 February 2022
Earnings visibility underpins divided target	Update	13 December 2022
Recycling champion	Update	12 July 2023
High- and growing-income opportunity	Update	7 March 2024

Source: Marten & Co

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