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Investing for a world of change

The power of debt to catalyse change

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"Follow the carbon" is a phrase we use frequently at Ninety One. It informs our focus when seeking out transition investment opportunities, and it's what we do when measuring their contribution to the global energy transition. Here's a clear example of this in action.

Following the carbon leads investors to a range of heavy-emitting sectors and industries, and the companies operating in these are often found in emerging markets. For instance, Chile is home to the world's largest copper mine, Minera Escondida, which was – until recently – fully reliant on coal for its energy use. In late 2020, Escondida's owners, BHP and Rio Tinto, initiated plans for a complete shift away from coal to renewable energy sources. But this carried a hefty price tag – a c.US$400 million penalty for early termination of a coal-based power purchase agreement (PPA) with AES Gener-owned Empresa Eléctrica Angamos SpA (a 558-megawatt generation facility in Chile's Antofagasta region).

Recognising both the investment potential (attractive credit quality and yield) and the opportunity to make a meaningful impact on carbon emissions, Ninety One helped anchor a US$417 million bond with a use of proceeds linked to the PPA termination payment, allowing the company to smooth out its payment obligation over time. As a result, in 2021, Escondida successfully facilitated the switch to renewable energy.

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Following the carbon since that deal was struck, we see that Escondida's Scope 2 emissions[1] dropped from 3.3 million tons of carbon dioxide equivalent (CO_2e) in FY2021 to 0.7 million tons in FY2022 and – crucially – to zero in FY2023. This is a great example of the power of transition debt to catalyse change.

What I find particularly exciting about this transaction is the knock-on effect it appears to have had. In October 2022, AES Gener announced 'Project Alba', which would invest around US$450 million to convert the aforementioned Angamos coal plant into a zero-emission renewable energy storage and generation system. While there were multiple considerations at play, the termination of Escondida's coal PPA would have surely improved the economic rationale for such a move.

The project is the first of its kind globally: the vision is to use abundant local renewable energy sources to provide the 700 megawatts of power needed to store thermal energy by heating the salts; these molten salts then act as a battery so that power can be added to the grid overnight when wind and solar generation is sparse. This is just one of AES Chile's 100% renewable projects, which aims to help the Antofagasta region become a hub of innovation and sustainable energy development. In November 2023, it received unanimous approval from the Antofagasta Environmental Evaluation Commission.

Not every transition investment opportunity will have such a clear effect on the carbon ecosystem in such a short timeframe. But I believe the Escondida example highlights how the financing of projects by operators trying to do the right thing — in this case BHP and Rio Tinto — can catalyse far-reaching positive change.

General risks All investments carry the risk of capital loss. The value of investments, and any income generated from them, can fall as well as rise and will be affected by changes in interest rates, currency fluctuations, general market conditions and other political, social and economic developments, as well as by specific matters relating to the assets in which the investment strategy invests. If any currency differs from the investor's home currency, returns may increase or decrease as a result of currency fluctuations. Past performance is not a reliable indicator of future results.

Specific risks **Emerging market:** These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems. **Default:** There is a risk that the issuers of fixed income investments (e.g. bonds) may not be able to meet interest payments nor repay the money they have borrowed. The worse the credit quality of the issuer, the greater the risk of default and therefore investment loss.

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1. Carbon 'scope': Scope 1 & 2 emissions are a proxy for how efficiently a company is managing its carbon emissions; the upstream part of Scope 3 provides an indicator of the carbon emissions in a company's supply chain; and the downstream part of Scope 3 is representative of the carbon emissions of a company's products as they are used during their life cycle. Scope 1 relates to the direct emissions from owned or controlled sources, for example fuel burned on site and company-owned vehicles. Scope 2 relates to the indirect emissions from the generation of purchased energy, steam, heating and cooling for the company's own use.

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