



Solid Energy Infrastructure Plays Aren't Going Away, Now Or Long-Term

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Sam Brothwell, director of research at Energy Income Partners. Read the Q & A below as Sam says that the frothy market for energy has created solid opportunities for infrastructure plays, such as pipelines, storage facilities, and liquid natural gas logistics companies. Brothwell discusses the emergence of renewables, noting that while they hold tremendous potential, they are not replacing legacy energy sources for use, and they should not replace those companies in investment portfolios either.



Sam Brothwell

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CHUCK JAFFE: Sam Brothwell, director of research for Energy Income Partners is here, and we're talking energy infrastructure investing now on The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator's brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry. From users and investors to fund sponsors and

creators, if you're looking for excellence beyond indexing The NAVigator's going to point you in the right direction. And today it's pointing us in the direction of Sam Brothwell, director of research for Energy Income Partners, which manages roughly \$4.5 billion dollars in long only energy infrastructure companies. That's mostly publicly traded pipeline companies and regulated utilities. You can learn more about the firm and what it does at EIPinvestments.com. And to learn more about investing in closed-end funds go to AICAlliance.org, the website for the Active Investment Company Alliance. Sam Brothwell, thanks for joining me on The NAVigator.

SAM BROTHWELL: Thank you, Chuck. It's great to be here.

CHUCK JAFFE: Energy infrastructure, a really interesting space right now because it's kind of been having its own reaction during the pandemic and the recovery. Some of it is pipeline companies, etcetera, are those proverbial toll takers, the kind of business that should always do well regardless of conditions. So explain right now what you're seeing that's driving gas and regulated utilities companies.

SAM BROTHWELL: Well, let's start with natural gas prices because there's certainly been a lot of attention paid to that. It started in Europe, Europe had seen sharp declines in domestic gas production, for example North Sea production's down close to 30% year-to-date versus 2020, and onshore gas is also in decline. That's why Europe has become much more dependent on imported liquified natural gas or LNG. Europe has historically imported gas from Russia and the Middle East, but recently added LNG from the United States. Our own gas production, as well as our ability to export LNG from the Gulf Coast was curtailed by storms this summer, and in a tight market it doesn't take much to upset the balance. Since LNG exports now link US gas to global markets, rising prices in other regions are affecting us as well. We should have ample gas supplies in the US this winter, but should also expect to pay a bit more.

CHUCK JAFFE: This is an old line legacy kind of industry that for years has been under some measure of attack. "Oh, we have to get towards solar." "We have to get towards renewables." How is that conflict playing out? Does it make any of these companies less attractive to you if you're not an ESG investor?

SAM BROTHWELL: Well, to kind of put things in perspective, energy has been transitioning since we discovered fire. The abundance of shale here in the US has allowed our energy

policy to shift from energy security to more of a focus on environmental impact. At the same time, the cost of electricity from wind and solar has dropped 70-90% in the past decade. So we're seeing a lot of interest in rapid adoption of renewable energy, and indeed it's something that we're very focused on. It's important to remember that this is a transition, and other critical performance attributes such as reliability, safety, and affordability can't be compromised. If that happens you wind up undermining public support. We're actually seeing that play out a bit in California, where a very aggressive push to go all-in on renewables and eliminate natural gas in power generation has started causing power reliability problems and shortages. Particularly when the sun goes down and solar production falls, that has actually forced many consumers in California to take reliability into their own hands, using backup generators often fueled by diesel to avoid power interruptions. That doesn't strike me as sound energy or environmental policy, and it sure isn't helping gain public confidence.

CHUCK JAFFE: So is the short answer that maybe renewables work and will eventually replace things, but it's not happening in yours or my or our audiences' investing lifetime?

SAM BROTHWELL: I think it's definitely happening. We've seen renewables pick up from a very small base, seen a decent amount of growth to being about 10% of electricity supplied today. But the simple fact is that fossil fuels still make up nearly 80% of primary energy, that's the energy that we start with. So it's going to be very difficult if not impossible to decarbonize over the next 15 to 20 years without using what we've got today. That means leveraging carbon capture utilization and storage technology to extend the life of existing natural gas fired power generation that is the most reliable and economic way to balance the intermittency of renewables.

CHUCK JAFFE: Sam, is what you're saying that for all the talk I hear about "I'm going to have to convert to solar," "Everybody's converting to solar," all this other sort of stuff, that that's going to happen to some extent but there's always going to be utility companies in my life and maybe in my portfolio?

SAM BROTHWELL: I think so. Certainly we hear a lot of talk about how the utilities are the industry to be disrupted by technology, and I don't see it happening that way. First of all, it'd be very costly for an individual customer to put enough renewable generation and batteries in to meet peak electricity loads that really happen for short periods of time. You'd have to

install so much stuff that would go unutilized most of the time, and that just doesn't make economic sense. I think it's far better to remain connected to a network. That is what the utility grid is evolving into, it's a network that can share resources more efficiently. Everything from solar panels on your roof to large scale wind and solar that the utilities themselves are investing in today. The growing use of electric vehicles, the need to charge them also calls for an intelligent grid, and we think transportation is emerging as a new opportunity for the electric utility sector. So while the fuel mix is changing, the need for the network is going to remain. Think of it this way, your smartphone is a very powerful piece of computing technology, but it's really limited when it's in airplane mode and not connected to a network of shared resources. So I think that network model is going to remain critical to making electricity reliable, affordable, and clean going forward.

CHUCK JAFFE: If we're talking about the kinds of legacy companies that you invest in, can they grow in an environment where they've got their own use and their own situations but they also have the pinch? Do you consider them to be growth companies at this point?

SAM BROTHWELL: Well, I think the assets that transport and store national gas, for instance, pipelines, storage facilities, LNG, and logistics, we think the current market conditions that we're seeing speak to the importance of those assets over time. And it's gotten much harder to build new pipelines, and so the ones that we have built that are providing that reliability, I think the incumbency value has increased. That said, it's not as simple as just buying an index or a basket of pipeline companies. You've got to understand how these companies' assets are positioned, how they're contracted, the regulatory backdrop, and the strength and weaknesses of the individual management teams.

CHUCK JAFFE: These days when people hear infrastructure, they're thinking what we hear about, the infrastructure bill etcetera, and lord knows, energy has been plenty politicized. But when you're talking about energy infrastructure investing and the ability to profit and grow going forward, it's not really the politicized infrastructure problem, you're not worried about political unrest somehow curtailing things. It's more, do we have enough and what's the demand picture, right?

SAM BROTHWELL: Yeah. So when I think about what we invest in, utilities and pipeline, that's very critical infrastructure. And as I mentioned, it's getting tougher to build new pipelines in particular, but there is definitely a need for this. When you think about public

policy, and there's a lot of focus on clean energy and decarbonization, 90% of the reductions in US carbon emissions since peaking in 2007 have been driven by the power sector through substituting natural gas and increasingly renewables for coal. So the utilities are making these investments in clean energy infrastructure, and as the cost of wind, and solar, and batteries come down, it's their customers that are benefiting from these cost reductions. The utilities as they make these investments earn a regulated return on capital that's driving a 5-7%, sometimes higher annual earnings growth, earnings that are also returned to investors as dividends. So I think about energy infrastructure and where the utilities sit, there's kind of a trifecta of lower power costs for consumers, strong earnings in dividend growth for investors, and furthering that public policy objective of decarbonization. That's where the utilities sit and we think it's a pretty attractive combination in the context of infrastructure investing.

CHUCK JAFFE: Sam, great stuff. Thanks so much for joining me to talk about it.

SAM BROTHWELL: Well, thank you for the opportunity to be here today, Chuck.

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