

The energy transition would be easy as technology exists, *but who will pay for it?* – that is the question



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Csaba is the founder of EnerSave Capital, a Luxembourg based finance facilitator for sustainable assets. With a focus on the energy transition, sustainable energy assets and the repacking of cash flows derived from sustainable investments into green bonds via securitisation. He is a seasoned investment banker, having held senior positions at Merrill Lynch, Prudential Bache, and sat on the board of Creditanstalt IB.

He has a broad experience in energy efficiency solutions and renewable energy generation implemented on an ESCo and on 'As a service' basis. He is also the founder of a UK based regulated entity that is active in the energy transition space.

Around 2017 I was attending a Bloomberg conference in London, where the head of the then Green Investment Bank, today a subsidiary of Macquarie, very eloquently explained the key issues for getting companies to decarbonize; *“the widget manufacturer will not use his own funds to pay for better lighting, but will use those funds to make a better widget, and not on improving the lighting in his production facility. If “you” however propose to him, that you will design it, install it, at no upfront cost, and he can pay from the savings he will sign on the dotted line”*.

Sounds easy, but the “you” meaning the installer or manufacturer needs to find the funding for such an installation. And here the problem starts with most bankers, who by reflex are used to lend against collateral, are now asked to put their project finance hat on, which means looking at the future cash flows of the operation and understand that modern lamps are more efficient than old ones and that yes, the consumption will be lower. Generally, a hard ask.

Why did I use lighting as an example and not heat pumps or similar, very simply, lighting is the technology which energy efficiency bankers understand best. Other technologies lag behind in Bankers understanding, but they will get there.

IFRS 16 complicating matters

Recent changes to the International Financial Reporting Standard or “IFRS” and in particular the treatment of leasing arrangements under IFRS 16, which is mandatory for all large or listed companies and investment funds. Long story short IFRS 16 makes leasing arrangements an “on balance sheet” item. This means that unlike earlier rules when leasing agreements have been treated “off balance sheet” meaning that they have been dealt with in the Notes to the financial statement, today they need to be recognised in the financial statements, which makes the treatment more complicated. Practically the practitioner needs to check under which reporting standards your client is reporting his financial statements. If your client reports under Generally Accepted Accounting Principles (GAAP) then there is no issue as companies using GAAP can treat leasing as earlier, but the larger clients will be under IFRS. Just to mark your card.

Creating a funded solution for your clients

Access to funding is the key in rolling out the energy transition, but the numbers are staggering. According to the EU Commission it will take each and every year 300 Billion Euro in investments to meet the 2030 and 2050 objectives, numbers which make climbing the Eiger North-face, look like a walk in the park.

But then let’s not get scare and discouraged by numbers, but let’s try to look at practicalities how to create replicable solutions which will as we at EnerSave Capital, which I chair, call it, get the “conveyor belt” rolling.

Standardization of contractual agreements

Our firm alongside BNP-Paribas has developed under the EU funded LAUNCH grant launch2020. eu created a standardized legal end client agreement which meets the requirements of end clients as to “off balance sheet” by adopting an “as a service” end client proposition and every participant of the funding value chain was sitting around the table.

This contract which today exists in 12 legal systems and languages is part of the Sustainable Finance Association sefaeu.org tool box and can be used by every practitioner as a standardized contract.

Why is this important? just imagine if every contract’s legal terms would be different, it would take an army of lawyers to verify them and this is simply unaffordable. Furthermore, for every financier a pipeline of transactions is of interest, however if these are all under different contractual agreements it is a complication which no one wants or needs.

Think about the car industry, the local VW dealer, will sell any kind of car to you, big small, fast or family vehicle, but the lease or loan agreement will always be the same contractual format.

The end client proposition - a case for “as a service”

The ESCO business model has been in and out of fashion over the past decades. We think it is a pretty clever solution to get scale into the energy transition, if it is done well with responsible people – and the funding by the financial community will be their subject to be able to show the “pipeline” i.e. a series of end clients willing to adopt such a proposal, standardization of contractual agreements, further described below, ESG & EU Taxonomy compliance and finally that it pays for itself around 5 to 7 years.

We see market trends whereby big corporations are willing to amend the ESCO model in the direction of the “as a service” which in essence has two key elements. First, one that the equipment supplier or manufacturer will keep ownership of the equipment and second will sell the output of such an equipment on a full maintenance contract basis.

Actually, and many customers like such proposals as they get what they want, either heating or cooling but they do not have ownership of the equipment which is an asset which they might or might not be able to pay for.

Many clients in the real estate sector need to have alternative proposals to meet their decarbonization goals, and “as a service” ticks many if not all the boxes as affordability, off balance sheet issues, and understand of complex measures.

Practitioners need to note that in today’s sales process, the engagement of all relevant parties is essential. These are the building manager, the chief sustainability officer or “CSO” and the chief finance officer or “CFO”.

The ‘as a service’ proposition creates an alignment of interest between building owner and technology supplier. Furthermore, it smooths the procurement process as, it is easy for the CFO to sign up to it, as it does not burden his balance sheet and neither his cash flow, as he only pays for the usage, which he had in a different format on his Profit & Loss statement (P&L) earlier. Today’s, energy saving building solutions are complex and interlinked and very often it is hard to comprehend for the building manager having been brought up with less IOT based equipment, and he does not want to take action out of fear for getting it wrong. As under the “as a service” the equipment supplier warrants a contracted output, all the manager needs to do is to define, with the occupants of the building the required output for the good operation of the building and sit back and let it happen. He has a long-term output at a fixed cost basis which the equipment supplier will need to deliver. Finally, the CSO will be able to claim a faster progress on the decarbonization, which is one of his key tasks.

When we talk to the industry it is interesting to see how they engage in this new field of activity, and for many end clients and manufacturers or distributors this represents the creation of long-term relationships instead of one-off sales, which ideally is where everyone would like to be.

Balance sheet issues

This is the big limitation factor, and your banker will think about this. What do we mean by this. Lending by bankers happens based on credit assessment, one of the key elements is the applicants balance sheet and its profit and loss account. Generally (simplification has its issues) banks will be comfortable to lend on a 1 to 4 basis, to a client of good repute, meaning that for every unit of equity banks will lend four units of debt.

Now once the 4 units of debt have been spent, there is no more ability to borrow, of which we need to be

mindful. Let's assume for simplification purposes that 1 unit is Euro 1 Mio.

For every lending banker, it will be important for the practitioner to have a plan how to move forward once the 4 to 5 Mio. are spent. This will be a key consideration in the overall lending process.

Finally - De-risking the balance sheet

One of the most practicable solutions is to sell receivables entered into with end clients, in order to permanently remove risk and rewards of such end client contracts is the process via securitization. <https://www.pwc.lu/en/pwcacademy/training-library/introduction-to-securitisation.html>.

In simplified example, the equipment supplier, sells his receivable to a securitization vehicle, one of which is the firm I chair enersavecap.com and this securitization vehicle then raises capital on the back of these receivable for capital market investors. As such the equipment supplier, will have moved the risk and reward from these contracts from his balance sheet, and will be able to repay its lending bankers and start with a new pipeline of projects, whilst keeping the revenues of ongoing maintenance for themselves.

Final thoughts

The “conveyor belt” is a key tool which EnerSave Capital propagates as a solution in the energy transition. All what is needed is a bit of planning and having a process approach.

Subject to, having contracted with proper credit worthy end clients (no default), and the equipment supplier acting properly (happy clients) and the initial lending banker having been repaid the amounts advanced (happy bankers want to re-lend to good clients) and the securitization investors having been repaid in due course, the equipment supplier is able to create a “conveyor belt” and a pipeline of contracts which will move his equipment out of the door, whilst maintaining a strong client relationship and the ability to upsell should a newer version of his equipment exists which saves even more energy.

To the question, I asked to one of our prospective clients, and a REHVA member, by how much he would expect to increase turnover if he would be able to sell “as a service” in the conveyor belt scenario, he responded “40% within 2-years without affecting of the traditional channels”. For a company having a turnover of currently 1.3 Bio. this is a big opportunity. ■

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