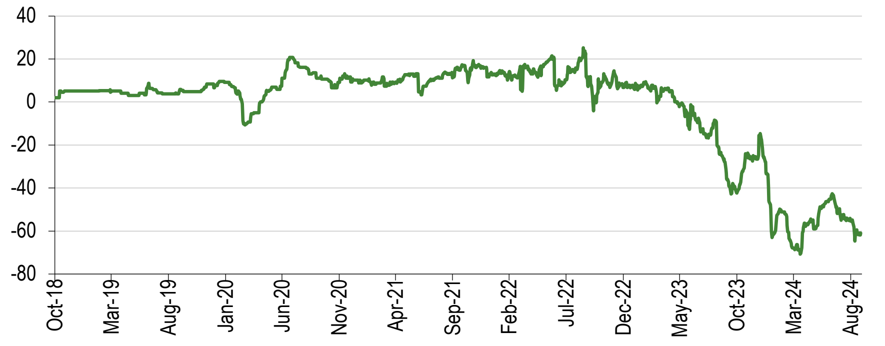
Gresham House Energy Storage Fund

Rising revenues and big plans for the future

Gresham House Energy Storage Fund (GRID) invests in utility-scale battery energy storage systems (BESS) in Great Britain. The sector had a tough start to the year, due to a deterioration in revenue conditions, but GRID's efforts to stabilise revenues and increase capacity are paying off. The manager, Ben Guest, is looking forward to a significant improvement in revenue in 2025, underpinned by a large, contracted earnings base, and plans for new pipeline projects, further augmentations to GRID's existing projects and associated revenue increases over 2025–27 will be revealed in November 2024. In a recent analyst call to discuss the release of GRID's H124 results, the manager confirmed that he is also eyeing opportunities in foreign markets. Some investors may see value in GRID's shares, which are trading at what is arguably an excessively wide discount to NAV.

Premium/discount to NAV since inception (%)



Source: LSEG Data & Analytics, Edison Investment Research

The analyst's view

- GRID remains the UK's largest owner and operator of BESS, with an operational portfolio that represents 20% of the market, significantly greater than the next largest owner, which holds 7.4% of operational projects (according to Modo Energy's Q224 GB BESS Index).
- The investment case for BESS rests on the integral role they play in the global transition to renewable energy. Despite the glitch in Q124, industry fundamentals remain supportive. Intermittent renewable energy generation is still increasing and will continue to do so as the UK and other nations strive to reach net zero emissions. This will underpin demand for BESS in Great Britain and around the world. It will also increase energy price volatility due to the intermittent nature of renewable energy generation, and hence trading opportunities, especially once the National Energy System Operator's (NESO's) trading platform is fully operational and able to utilise BESS more fully.
- Efforts by the manager and the board to stabilise the company have left GRID well-placed to benefit from these favourable developments, and to resume dividend payments in 2025 (see our last note for details).
- Those focused on sustainable investments may appreciate GRID's contribution to the transition to renewable energy. The company also offers the opportunity to invest in real assets that are often difficult to access.

NOT INTENDED FOR PERSONS IN THE EEA

Investment trusts
Renewable energy infrastructure

2 October 2024

Price		**53.1p**
Market cap		**£302.2m**
AUM		**£621.2m**

NAV*		109.16p
Discount to NAV		51.4%
*Including income. As at 30 June 2024.		
Yield*		0.0%
*No FY24 dividend expected.		
Ordinary shares in issue		569.1m
Code/ISIN		GRID/GB00BFX3K770
Primary exchange		LSE
AIC sector		Renewable Energy Infrastructure
52-week high/low	111.4p	38.2p
NAV* high/low	146.7p	95.6p
*Including income.		
Net gearing at 30 June 2024		1.4%

Fund objective

Gresham House Energy Storage Fund seeks to provide investors with an attractive and sustainable dividend over the long term, by investing in a diversified portfolio of utility-scale battery energy storage systems located in the UK and Ireland. In addition, the company seeks to provide investors with capital growth through the reinvestment of net cash generated in excess of the target dividend.

Bull points

- Efforts during H124 have stabilised revenues and increased operational capacity.
- The company's forthcoming capital markets day will reveal plans for further growth.
- With the share price discount still at an extreme and arguably unjustified level, now may be a particularly good time to acquire or top-up exposure.

Bear points

- The upgrade to NESO's trading platform is taking longer than expected, and this is adversely affecting access to trading revenues.
- Future expansion plans are dependent on the availability of funding.
- A lack of infrastructure to support the generation and distribution of solar and wind power may slow the UK's transition to renewable energy.

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Edison profile page

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GRID: Looking ahead with confidence

Company's stabilisation strategy is working

The BESS sector faced a challenging period during the first half of 2024 (H124), due to a sharp deterioration in the revenue environment in Q124 and the slower than expected implementation of NESO's Open Balancing Platform (OBP), which is intended to automate National Grid's control room and thus improve access to trading opportunities for battery operators. As reported in a recent trading update (see our last note for details), GRID's NAV per share declined to 109.16p at end June 2024, down 19.91p since 31 December 2023. Third-party revenue forecasts contributed 19.47p of this decline, principally due to a general reduction in revenue assumptions by third-party forecasters, combined with the introduction of a new, more conservative third-party provider. The adverse impact of this and other more minor factors on GRID's NAV was partially offset by the favourable influence of the revaluation of several pipeline projects as they came on-line, and share buybacks, which are accretive to NAV.

During H124, GRID's manager, Ben Guest, and its board implemented a strategy to stabilise the company and see it through this difficult period. This strategy focused on near-term cash flow generation and completing GRID's 2024 construction pipeline projects. This strategy has yielded positive results, assisted by an improvement in the market environment since its nadir in Q124.

Revenue prospects improving

GRID's operational portfolio revenues decreased 12.8% year-on-year to £17.9m in H124 (H123: £20.5m), and EBITDA declined 23.9% to £10.4m (H123: £13.8m), due to the poor market conditions during Q124. However, revenues have since begun to rise. Net revenues in July and August averaged their highest levels of the year so far and were c 25% higher than average net revenues in H124.

GRID's revenue outlook has been further enhanced by a landmark tolling arrangement with Octopus Energy, which was agreed in May 2024. This deal ensures a significant improvement in revenues in 2025, as it contracts over half of GRID's portfolio (568MW) for two years, starting in H224, at a level above current merchant revenue levels. It thus gives the company significant certainty on more than half of its revenues over this two-year period. Since the end of H124, 170MW of assets have been onboarded by Octopus under this tolling arrangement, with the remaining projects expected to transfer by the end of 2024. GRID's manager estimates that using merchant revenue levels as at August 2024 (based on Modo Energy estimates), earnings should more than double from their current (H124) annualised rate of £20.8m to £45.7m during the tolling arrangement, due purely to this deal and the expected increase in operational capacity over the remainder of 2024. This is a conservative estimate given that merchant levels are forecast to rise over this period.

2024 project pipeline, and augmentations, nearing completion

The second half of 2024 is expected to see the conclusion of GRID's current construction programme of new projects and augmentations to several already operational projects, which are a very profitable way of increasing capacity, as they take only two to three months to implement and cost relatively little (see Exhibit 1). Once complete, the capacity of GRID's operational portfolio will increase from its current level of 790MW (up 14.5% from end December 2023) to over 1GW for the first time, with an average battery duration of 1.6 hours.

However, despite this push to expand capacity, as previously announced, the manager is seeking to sell some existing projects to reduce leverage. The company is in discussions with several interested parties, but no deals have yet been concluded.

Exhibit 1: Investment portfolio (as at 30 September 2024)

Existing assets	Location	Capacity* (MW)	Capacity post augmentation (MW)	Site type	Commissioning status	Ownership status
1. Staunch	Staffordshire	20	20	Battery & generators, 0.5MW import	Operational	100% owned
2. Rufford	Nottinghamshire	7	7	Battery & generators, symmetrical	Operational	100% owned
3. Lockleaze	Bristol	15	15	Battery, symmetrical	Operational	100% owned
4. Littlebrook	Kent	8	8	Battery, symmetrical	Operational	100% owned
5. Roundponds	Wiltshire	20	20	Battery & generators, 16MW import	Operational	100% owned
6. Wolverhampton	West Midlands	5	5	Battery, symmetrical	Operational	100% owned
7. Glassenbury	Kent	40	40	Battery, symmetrical	Operational	100% owned
8. Cleator	Cumbria	10	10	Battery, symmetrical	Operational	100% owned
9. Red Scar	Lancashire	49	49	Battery, symmetrical	Operational	100% owned
10. Bloxwich	West Midlands	41	41	Battery, symmetrical	Operational	100% owned
11. Thurcroft	South Yorkshire	50	50	Battery, symmetrical	Operational	100% owned
12. Wickham Market	Suffolk	50	50	Battery, 40MW import	Operational	100% owned
13. Tynemouth	Tyne & Wear	25	25	Battery, symmetrical	Operational	100% owned
14. Glassenbury Extension	Kent	10	10	Battery, symmetrical	Operational	100% owned
15. Nevendon	Basildon	10	15	Battery, symmetrical	Operational; augmentation Nov 24	100% owned
16. South Shields	Tyne & Wear	35	35	Battery, symmetrical	Operational	100% owned
17. Byers Brae	West Lothian	30	30	Battery, symmetrical	Operational	100% owned
18. Arbroath	Scotland	35	35	Battery, symmetrical	Operational; augmentation complete	100% owned
19. Enderby	Leicestershire	50	50	Battery, symmetrical	Operational; augmentation complete	100% owned
20. Stairfoot	North Yorkshire	40	40	Battery, symmetrical	Operational	100% owned
21. Coupar Angus	Scotland	40	40	Battery, symmetrical	Operational; augmentation Dec 24	100% owned
22. Grendon 1	Northamptonshire	50	50	Battery, symmetrical	Commissioned July 2023	100% owned
23. West Didsbury	Manchester	50	50	Battery, symmetrical	Operational; augmentation complete	100% owned
24. York	York	50	50	Battery, symmetrical	Commissioned Jan 2024	100% owned
25. Penworthham	Preston	50	50	Battery, symmetrical	Operational; augmentation Oct 24	100% owned
Operational portfolio (A)		**790**	**795**			
Pipeline summary						
Pipeline projects						
26. Melksham	Wiltshire	100	100	Battery, symmetrical	Target Oct 24; augmentation Dec 24	100% owned
27. Bradford West	West Yorkshire	87	87	Battery, symmetrical	Target Dec 24	100% owned
28. Elland 1	West Yorkshire	50	50	Battery, symmetrical	Target Oct 24	100% owned
29. Shilton Lane	Scotland	40	40		Target Oct 24	100% owned
Total operational or under construction		**1,067**	**1,072**			
31. Walpole	Norfolk	100	100		2026	100% owned
Total portfolio owned by the company (pre potential disposals)		**1,167**	**1,172**			

Source: Gresham House Energy Storage Fund. Note: *Capacity in MW is the flow rate of energy, while MWh is battery size (ie storage capacity). A 1MW connection with a 1MWh battery takes one hour to discharge.

And more upgrades and projects are in the pipeline for 2025–27

Looking beyond 2024, the company's H124 results revealed that subject to the availability of fresh funding, the manager is considering opportunities to augment more of GRID's existing portfolio in 2025, and also to resume work on the company's long-term construction pipeline. Increasing the portfolio's capacity from 1.6 hours duration to 2.0 hours during 2025, as Guest proposes, would add 300–400MWh to existing capacity of 1,701MWh, and generate 'considerable potential revenue upside'. These augmentations and new project plans, and possible solutions to the company's current capital constraints, will be the subject of a three-year plan to be revealed at a capital markets day in November this year. The plan is intended to maximise capacity, revenues and cashflow from 2025 to 2027, while reducing the volatility of earnings. Details of this event will be released in due course.

In the analyst update following the release of GRID's half year results, Guest noted the current low level of battery prices and stressed that even taking a conservative view on revenue uplifts from duration extensions, such augmentations represent an exciting returns opportunity for the company. Given this, he indicated that he would consider further augmentation of existing assets up to three or four hours, once the immediate plans to increase portfolio duration to two hours have been realised. He also confirmed that he and his team are closely monitoring investment opportunities in foreign markets. The events of Q124 prompted them to indefinitely defer plans for GRID's first foreign investment, in the US-based Project Iliad, but Guest sees opportunities for future investments not only in the US, but also in Europe, Australia, Japan and Canada. As Guest notes, 'everyone needs batteries', and he seems determined to resume GRID's expansion into foreign markets as soon as circumstances and financing allow.

Industry fundamentals also supportive

With revenues set to rise significantly during 2025, and capacity also likely to rise over time, subject to funding, GRID is in a stronger, more stable position than it was in Q124, well-positioned to benefit as market conditions continue to improve. Guest argues that 'fundamentals are on our side'. Battery prices are falling, increasing the ability of new pipeline projects to achieve attractive returns. In addition, the penetration of renewable energy sources is rising, as expected, and will continue to do so. The last of the UK's coal-fired power plants was retired on 30 September 2024, and nuclear power plants are being phased out over the rest of this decade. Greater reliance on renewable energy will increase power price volatility, especially for longer duration batteries. Furthermore, while the transition to NESO's new platform has been slower than expected, it is still progressing and, with time, should improve trading conditions and revenues for GRID and its BESS competitors.

Board prioritising resumption of dividend payments in 2025

GRID suspended dividend payments in February this year to preserve cash as the revenue environment worsened. However, GRID's chairman noted in the company's half-yearly report that efforts this year to increase revenues provide 'a supportive backdrop for the recommencement of dividend distributions'. The board expects to revisit the dividend policy in 2025, and has indicated that the resumption of dividend payments remains 'a key priority', subject to discussions with shareholders.

Very wide discount may be an attractive investment opportunity

Until a year ago, GRID's shares usually traded at a premium to cum-income NAV (see chart at the start of this note), but a sharp share price decline over the past year has seen the share price enter discount territory. The company initiated a programme of share buybacks in February 2024, repurchasing a total of 4.4m shares before buybacks ceased in April 2024, to focus capital allocation to the construction of new projects and augmentations. The discount exceeded 60% at this point but has since narrowed to closer to 50%. This is likely to be due at least in part to the improvement in GRID's revenue outlook over recent months, especially since the agreement of the tolling arrangement with Octopus Energy.

In addition, investors may be beginning to see value in the shares. Alternative valuation estimates released by GRID for the first time in its H124 results show that at current merchant revenue levels and based on current operational capacity and the tolling arrangement discussed above, the company is valued at 9x EV/EBITDA, with a P/E ratio of 5.7x, on a forward basis. However, capacity is set to rise by end 2024, and medium- to long-term revenues are forecast to increase significantly based on third-party revenue curves, so both the EV/EBITDA and P/E ratios are likely to fall over time. This suggests the company's shares offer potential value at their current level.

The current wide and arguably unjustified discount may represent an opportunity for those investors who share the confidence of GRID's manager and board in the long-term viability of the battery storage industry and in the company’s prospects. It will take more time for conditions in the sector to improve, and for GRID’s revenues to fully reflect recent developments, but as and when they do, the company’s share price discount has significant scope to narrow back towards its historical levels.

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