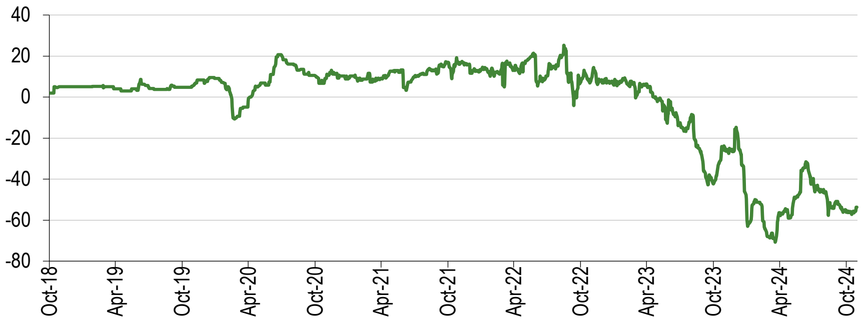
Gresham House Energy Storage Fund

Improving prospects suggest discount is overdone

At the recent capital markets day, Gresham House Energy Storage Fund (GRID) detailed positive developments in H224, including growing capacity and rising revenues. It also revealed a three-year plan to achieve further growth and triple earnings, from an estimated £45–55m in 2025, to £150m in 2027. Funding is expected to come from a new project finance style arrangement based on contracted revenues. Subject to the successful conclusion of related refinancing, expected in Q125, the company plans to reinstate fully covered dividend payments from Q325. GRID is also negotiating an equity investment in one of its sites. This deal would potentially serve to confirm GRID's valuation methodology, giving investors confidence that the current NAV is a realistic estimate of its true worth. GRID's share price is currently at a significant, historically wide discount to NAV, but this deal, combined with other positive recent developments and GRID's plans for further improvements in capacity and revenues, suggests the discount is excessive and likely to narrow significantly as the company's plans are rolled out (see chart below).

Premium/discount to NAV since inception (%)



Source: LSEG Data & Analytics, Edison Investment Research

The analyst's view

- GRID efforts to address significant challenges to its trading environment are paying off. Capacity will soon hit a milestone of 1GW, and revenues are rising, thanks to improved trading conditions and a landmark contract with Octopus Energy (see our note of 2 October 2024). The manager expects 2024 EBITDA to exceed its 2023 level of £25.8m, and to rise to at least £45m in 2025.
- GRID's three-year plan for 2025–27 features further augmentations to existing projects, a new UK project pipeline and additional revenue sources.
- The company estimates that if EBITDA reaches the projected level of £45–55m next year, cash flow per share (net of costs) will be in the range of 4.5–6.2p per share. This suggests the possibility of a reinstated dividend of a similar size, somewhat lower than the last full year dividend of 7.0p paid in respect of FY22 and the two prior years.
- The fundamentals of the battery energy storage system (BESS) sector remain very supportive and with capacity and revenues set to keep rising, GRID's current wide discount seems unjustified. This may represent a potentially attractive opportunity for those who share the confidence of GRID's board and manager in the company's longer-term prospects.

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Investment trusts
Renewable energy infrastructure

4 December 2024

Price		**50.6p**
Market cap		**£288.0m**
AUM		**£620.8m**
NAV per share*		109.1p
Discount to NAV		53.6%
*Including income. As at 30 September 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	110.6p	38.2p
NAV* high/low	146.1p	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 recent capital markets day outlined plans for further significant increases in capacity and revenues, and a new revenue-based approach to financing.
- Investors will welcome the reinstatement of the dividend, albeit at a lower level than the past full year payments.

Bear points

- Future expansion plans are dependent on a successful refinancing.
- The upgrade to NESO's trading platform is taking longer than expected, and this is adversely affecting access to trading revenues.
- 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

Gresham House Energy Storage Fund is a research client of Edison Investment Research

GRID: Unlocking capital to fund growth and raise revenues

Trading update included several positive developments

GRID held a capital markets day (CMD) on 27 November 2024 at which the company provided a trading update and details of a three-year plan to achieve further growth in capacity and revenues over 2025–27.

The BESS sector has faced significant challenges over the past year or more, due to a deterioration in revenue conditions. GRID responded to these developments by refocusing its capital allocation to prioritise increasing capacity via the completion of its 2024 project pipeline and augmentations to several existing projects. Measures included a suspension of GRID's dividend and efforts to reduce debt (see previous notes for details). At the CMD, GRID's chairman, John Leggate, said these efforts are bearing fruit, as they have stabilised the business from a revenue perspective and laid the base for future growth.

The CMD provided details of several positive developments over 2024:

- The company's 2024 project pipeline is now almost complete, as are augmentations to five already operational projects. This has lifted current capacity to 845MW across 26 operational projects, from 790MW across 25 projects at end September 2024. And capacity is due to reach 1,072MW (c 1GW) across 30 projects by end Q125 (see our 2 October 2024 note for pipeline details). Reaching this key milestone is taking slightly longer than previously forecast due to delays related to a couple of projects.
- GRID's revenues have also been rising, thanks in part to an improvement in trading conditions in recent months, and a landmark tolling arrangement with Octopus Energy. As a result of these developments and the more efficient use of its batteries, the company expects its 2024 EBITDA to exceed its 2023 level of £25.8m, and to rise to at least £45.7m in 2025, and possibly as high as £55m, under current trading conditions and based on GRID's current operational portfolio. EBITDA of £45.7m would return revenue to the levels seen between 2021 and early 2023.
- The company has also reached in principle agreement with a potential partner on a deal involving an equity investment in its Glassenbury project. This deal, which is expected to close in Q125, will provide funding to lift this project's duration from less than one hour, to four hours, making it GRID's first four-hour project. Glassenbury currently has 38MWh of operational capacity, but improvements to BESS technology mean that the same area can now accommodate 220MWh, an augmentation that will offer 'an attractive double-digit return', helped in part by lower BESS prices. Negotiations regarding this investment are based on Glassenbury's current valuation, as reflected in GRID's NAV. As such, the deal would be a benchmark transaction that confirms GRID's valuation methodology and is thus likely to give investors confidence in GRID's current NAV as a realistic estimation of its true worth. GRID's manager, Ben Guest, told attendees at the CMD that similar co-investment opportunities exist across GRID's whole portfolio.
- Looking at the BESS sector as a whole, fundamentals are improving. The penetration of renewable energy is rising, as the last coal-fired power station closed in September 2024 and the UK's gas and nuclear fleets are set to shrink. And the trend towards electrification is still in its nascent stages. For example, electric vehicles (EVs) currently comprise only 4% of the UK market, but their market share will rise rapidly, as the sale of new petrol and diesel cars will be banned from 2035. Wind and solar generation is surging, increasing demand for BESS to store this intermittent energy until it is needed, yet growth in the UK's BESS fleet slowed in 2024, reducing GRID's near-term competition.
- Finally, the regulatory environment is becoming more supportive. The new UK government has made a strong commitment to BESS as an integral part of its Clean Power 30 initiative. This includes a requirement of 22GW of nationwide BESS capacity, a fourfold increase in the

current level of less than 5GW. In addition, the UK's National Energy System Operator (NESO) is accelerating upgrades to its Open Balancing Platform, which will improve the utilisation of BESS, giving GRID and its competitors greater access to lucrative opportunities to supply energy to the system during peak periods.

Three-year plan to lift earnings dramatically

These favourable developments provide a strong base for GRID's future growth. The company has big plans for further augmentations to existing projects, and a pipeline of new projects, which the company forecasts will lift revenues very significantly. Assuming a successful refinancing of its funding arrangements next year (see below) and based on current trading conditions, GRID's manager is targeting EBITDA of £150m by 2027.

Specifically, this increase in EBITDA will be driven by:

- 1.5GWh of augmentations to existing projects during 2025–27, lifting EBITDA by £33m (Exhibit 1).
- 680MW of new projects over 2026–27, forecast to raise EBITDA by £47m (Exhibit 2). (These projects will all be located within the UK, but the manager reiterated his intention to revisit opportunities in other countries once next year's refinancing is completed).
- Possible further development of the relationship with Octopus Energy, which both parties agree has been highly successful so far. Comments made at the CMD by Octopus's head of flexibility, Kieron Stopforth, suggested Octopus would welcome the opportunity to expand its current tolling arrangement. GRID is also considering other tolling arrangements.
- An estimated £25m of revenues from alternative sources. The company is exploring different ways of accessing the market, but details are so far limited.

Exhibit 1: Augmentation pipeline (as at 27 November 2024)*

Project	Capacity** (MW)	Capacity before augmentations (MWh)	Capacity post augmentation (MWh)	Expected completion time
1. Coupar	40	40	80	Q125
2. Melksham East	50	50	100	Q125
3. Melksham West	50	50	100	Q225
4. Glassenbury	50	38	220	Q325
Total capacity	**190**	**190**	**500*** **	

Source: Gresham House Energy Storage Fund. Note: *Subject to availability of finance **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. ***Additional augmentations to lift total capacity increase to the projected 1.5GWh are yet to be announced.

Exhibit 2: New project pipeline (as at 27 November 2024)*

Project	Capacity (MW)	Battery capacity (MWh)	Target energisation	Ownership	Status of planning permission
1. Elland 2	100	200	2026	Exclusive pipeline	Granted
2. Cockenzie	240	480	2026	Exclusive pipeline	Submitted, expected in Q125
3. Monet's Garden	50	200	2027	Exclusive pipeline	Submitted, expected in Q125
4. Lister Drive	50	150	2027	Exclusive pipeline	Submitted, expected in Q125
5. Ocker Hill	240	480	2027	Exclusive pipeline	Submitted, expected in Q125
Total pipeline	**680**	**1,510**			

Source: Gresham House Energy Storage Fund. Note: *Subject to availability of finance.

Expansion funded by a blended approach to financing

It is GRID's intention to fund these ambitious plans using a new, blended contracting approach to financing. This approach takes advantage of the evolving BESS market, to move GRID away from a primarily merchant model, towards amortising debt arrangements sized off contracted revenues. Such debt arrangements are made possible by the emergence of long-term revenue contracts such as the Octopus tolling deal, which greatly reduce the risk of unexpected revenue declines of the kind that undermined GRID's revenue in late 2023 and early 2024. Such revenue-backed debt financing arrangements are a well-established model used widely in project financing. GRID is currently in negotiations to refinance all its existing debt via this kind of facility, which will bring the additional benefit of lower borrowing costs thanks to floating rate terms, set in a declining rate environment. The arrangement is expected to be finalised in Q125.

Under current arrangements, 67% of GRID's revenues are contract based and thus eligible for inclusion in project financing arrangements. However, it is the manager's intention that a portion of the company's asset base will remain uncommitted to debt servicing, preserving the flexibility to capture revenue upside via trading opportunities that emerge during periods of high energy price volatility.

Dividend to be reinstated from Q325

The recent improvements to GRID's revenue prospects, combined with the company's plans for further expansion in capacity and revenues over the next three years, have cleared the way for a reinstatement of dividend payments. Subject to the successfully conclusion of the refinancing negotiations currently underway, it is the board's intention to recommence dividends payments from Q325, in respect of Q225. Future dividends will be fully covered, after costs. For each full financial year, the dividends for the first three quarters will be smaller, and the final dividend larger.

In terms of the potential size of future dividend payments, the company has not yet committed to a particular dividend amount, but it has stated that if EBITDA reaches the projected £45–55m in 2025, cash flow per share (net of interest costs, charges and expenses) will be 4.5–6.2p per share. This suggests the possibility of a dividend within this range, which would be lower than the last full year dividend of 7.00p per share paid in respect of FY22, and the two previous years.

Recent developments suggest wide discount is unjustified

The challenges faced by the BESS sector in the past year have caused the share prices of GRID and its competitors to fall significantly. After trading at a premium to NAV since the company's inception in 2018, GRID's shares moved into discount territory in mid-2023. The discount peaked at 60% in early 2024 but has since settled around 50%. Initial reaction to this latest news from GRID has been muted but, in our view, the investor scepticism implied by this discount is unjustified. GRID appears to be on a financially stable, sustainable growth path, and the succession conclusion of current negotiations regarding the Glassenbury equity investment would provide an NAV valuation benchmark that should serve to reassure investors.

For those 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, the current historically wide discount may represent an attractive opportunity. It will take time for GRID's revenues to increase as forecast, but as and when they make progress in this direction, the company's share price discount has significant scope to narrow back towards its historical levels.

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