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INFRASTRUCTURE INVESTOR

Favourable tailwinds

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Chinese fund manager CGN Private Equity is turning its attention to foreign investors for its third fund, which focuses on renewable energy. Raymond Fung, the fund's chief investment officer, tells Andy Thomson why

For managers on the fundraising trail, winning over investors can be a long and arduous task. But for Shenzhen-based CGN Private Equity Fund Management Company (CGN Private Equity), it's arguably as simple as pointing to a report.

The report in question is EY's Renewable Energy Country Attractiveness Index (RECAI), the June 2015 version (Issue 44) of which shows China sitting proudly on top of the table of 40 nations from around the world. Ahead of the US in second place, China is viewed as the most attractive market in four out of eight sectors (onshore wind, solar PV, biomass and hydro).

Small wonder that Raymond Fung, chief investment officer at CGN Private Equity, is "very confident about our Fund's strategy". Its third fund, CGN Capital Partners Fund III (CGN Fund III) - which will focus on renewable energy sectors including wind, hydro and solar power - has just raised $300 million at first close from domestic investors. It is now turning its attention to international backers as it seeks to post a final close on $800 million in May next year.

FAVOURABLE IMPRESSION

In conversation with Infrastructure Investor in Hong Kong, Fung adds to the favourable impression created by EY's index by pointing out that, at the end of last year, China had some 1.36 million megawatts (MW) of installed capacity - some 14 times the amount in the UK, of which 424,000MW is renewables, and the installed capacity base is growing at circa 70,000MW per year, mostly renewables and nuclear. Capacity in the wind sector alone is bigger than the UK's entire installed capacity.

The reasons for China's increasing shift to renewable energy is obvious in the smog that famously hangs like a blanket over Beijing on a regular basis. "Every country goes through this phase in their development where major cities are polluted," says Fung, "but now people in China are more affluent and, as their demands and expectations increase, the health issues have to be dealt with."

With the future of coal seen as unsustainable due to the huge amount of related water consumption and environmental disasters - such as the drying up of many rivers in Shanxi province, for example - a new sustainable energy strategy was launched by the Chinese government some 10 years ago. "They are executing exactly what they said they would execute," insists Fung. "They have been very steadfast, and there has been a drive to invest in nuclear and renewable energy."

Nuclear energy is certainly part of the solution. CGN Fund III's sponsor is China General Nuclear Group, the $63 billion Chinese clean energy firm which operates 60 percent of China's nuclear power stations and is a partner in the construction of the new Hinkley Point C nuclear plant in the UK. Indeed, the firm's first fund - a $1.1 billion vehicle which closed in 2010 - was focused on nuclear power station investments.

However, the need to identify precisely the right kind of site for nuclear stations and then meet stringent operational standards means that the development of the industry has been painstaking. "You can't do nuclear quickly, you have to be meticulous," Fung stresses. He points out that CGN's first nuclear power station is now 20 years old, but there was still only 20 gigawatts of installed nuclear capacity in the country by the end of 2014 with circa 5 gigawatts added per year. "Wind now has four times the capacity of nuclear and it only started around 2008/09," he adds.

COSTS TUMBLING

The logic for renewable energy is thus overwhelming, especially with long-run average costs per MWh of production having fallen by around 90 percent over the last 25 years - together with the expectation that costs still have the capacity to come down even further in the period ahead. But, given the obvious attractions, could CGN perhaps have targeted a larger amount? What makes $800 million the right size?

"The pipeline is ginormous," says Fung, "but we're constrained by the size of the investment team. We can't just go out and hire 15 people as there are not enough quality professionals out there. We hire young guns who we can mould or people who have worked with me before and I trained them. You can't easily hire international staff and bring them into the market because they don't understand the idiosyncrasies of China."

While trying to find the right professionals is a tough task, Fung always appeared a good fit for CGN. For one thing, he brought with him highly valuable renewable energy investment experience. Way back in 2005, the Global Wind Partners investment fund, which he founded while at Babcock & Brown, was successfully listed on the Australian Stock Exchange as Babcock & Brown Wind Partners.

Having spent almost three years as head of infrastructure investment at Chinese insurance company Ping An, Fung was about to launch a sustainable development fund at infrastructure investment and advisory boutique JIDA Capital when CGN came calling in 2012 and brought Fung and JIDA on board. Fung was tasked with helping CGN to move to the next level, including broadening its appeal to an international investor base.

STRATEGIC PARTNER

One of the first things Fung did in his new role was to seek a strategic partner which could help provide a global perspective. The search ended in Australasia, with HRL Morrison now owning a "significant equity interest" in JIDA.

"They [HRL] are a very long-term infrastructure investor, they have been doing it for more than 20 years with a highly successful track record in wind and hydro," Fung points out. "They also have deep operational expertise when it comes to managing the assets, and that's exactly what we wanted. We wanted to bring the science of managing infrastructure assets into the Chinese market and apply it in a Chinese way. This separates us apart from our peers."

The partnership saw Anthony Muh, HRL Morrison's chief executive officer of asset management based in Hong Kong, become a non-executive member of CGN Fund III's investment committee.

The aim now, as CGN Fund III moves towards a hoped-for second close in November this year, is to continue building "a very high quality partnership base". Domestic investors to have committed to the fund so far include the likes of Industrial and Commercial Bank of China and Cinda Asset Management, the largest bank in China and the largest asset management company respectively.

While Fung views these as "first-tier" investors, he says that "second-tier" investors in China are not ready for the fund because of their lack of familiarity with private equity infrastructure funds and with making long-term investments. This at least in part explains the need to reach out to investors outside of the country.

"Some international investors have a very long history in infrastructure so they have open minds," says Fung. "There is also a hunger for yield and they are looking a bit more at 'frontier' opportunities such as greenfield and away from OECD markets. Having international institutional capital working with us could help more Chinese institutional investors to get comfortable with the asset class and open them up to providing long-term equity capital to infrastructure."

SAME TERMS

Attracting overseas investors has been made easier by the Qualified Foreign Limited Partner (QFLP) programme, which was launched in Shanghai in 2011. The QFLP differs in only small ways from the limited partnership structure that foreign investors are familiar with in their home jurisdictions and has helped to attract big global private equity firms such as Blackstone and KKR to China.

"The QFLP regime means that everyone is investing on the same terms," says Fung. "The pilot programme has been a great success and implementation rules put in place in 2014 and 2015 moved it from being local to national regulation, effectively making it a national policy and moving it beyond the local trial stage."

With international investors now able to effectively commit their capital on the same terms as local investors, Fung is confident that potential supporters will examine CGN's deep roots in its domestic market and conclude that CGN Fund III is a compelling opportunity for investors to tap into China's renewable energy growth story.

"Most international investors think China is a very big market but it is too hard to crack and they give up," says Fung. "We have been casting the key for investors to access the market under the radar for many years. We systematically and patiently built team, track record, partnership and trust over time. We think we will impress international investors with what we have."