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Insight INVESTMENT

WHAT DOES PRESIDENT TRUMP'S ENERGY INDEPENDENCE POLICY MEAN FOR INVESTORS?

On March 28, 2017, President Trump signed the Energy Independence Policy Executive Order that directed the US Environmental Protection Agency to roll back some elements of President Obama's Clean Power Plan (CPP). These are the president's first steps in reducing environmental regulations in order to stimulate job creation and business investment specifically within the coal industry. However, we believe economic rather than regulatory factors are responsible for the decline of the coal industry, and the regulatory reforms are unlikely to produce a material effect.

We do not expect the executive order to have a material impact on the utility providers in which we currently invest. The day after the president signed the executive order, Insight met with six large utility companies that provide energy throughout the US. All stated that the CPP, and/or a reduced regulatory burden, will not impact their current plans either to shut down old coal plants or to continue pursuing renewable alternatives. Many are under pressure from investors and clients to introduce clean energy strategies or services, and at present the US remains committed to reducing overall carbon emissions in keeping with the COP 21 Paris agreement. It remains unclear whether the Trump administration will go further to rescind or change existing measures and regulations that remain in place, such as subsidies, carbon emission targets and carbon regulations.

COAL IN DECLINE

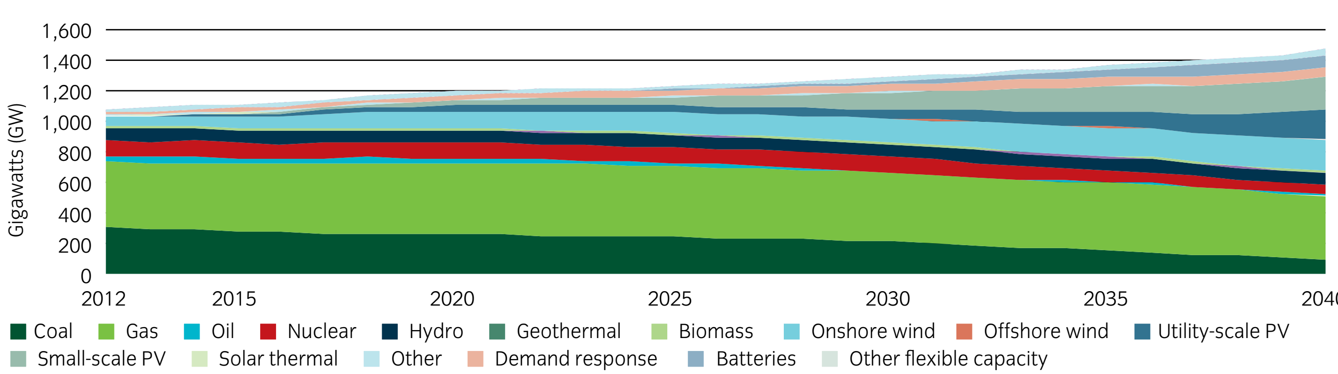
Data suggests that new energy generation in the US will be increasingly comprised of power from renewable energy sources, which are forecast to account for c.50% of total power generation by 2040 (see Figures 1 and 2 which show the projected change in energy production from different sources).

Our analysis suggests that economic factors rather than regulation are deciding the future for energy, including the scope for employment.

Factors to consider include the following:

- A chief consideration has been the trend in falling energy prices over the last three years, which has made the coal industry less competitive, given inherently higher fixed and variable costs compared to other energy sources.
- This trend has been compounded by the increased competitiveness of natural gas since 2008, given the shale gas revolution in the US. Over the last decade competitive drilling in the largest natural gas fields in the US, the Marcellus and Haynesville formations in eastern North America and Arkansas respectively, has resulted in natural gas prices falling 80% since 2008. The use of natural gas over this period has also surged.
- Jobs in coal production have also been under threat from technological progress. These effects have been notable in a number of US regions.

Figure 1: Projected change in US energy capacity mix (GW)



Source: Bloomberg New Energy Outlook 2016. As of June 17, 2016.

One utility firm has told Insight that running a coal plant takes 300 people, while an equivalent gas plant requires only 30. It added that producing power from a coal plant has become more expensive than producing that energy from renewable sources instead, with costs at a coal plant at approximately $40 per megawatt-hour (MWH) compared with $20 per MWH from a renewables plant. A second utility company said that even when current green energy subsidies end, given expected improvements in technology, the cost to produce energy from renewables will likely still be competitive.

As a result of these factors, we believe the coal industry is facing an inevitable, gradual long-term decline that cannot be rescued by government policy.

RENEWABLE ENERGY USE RISING

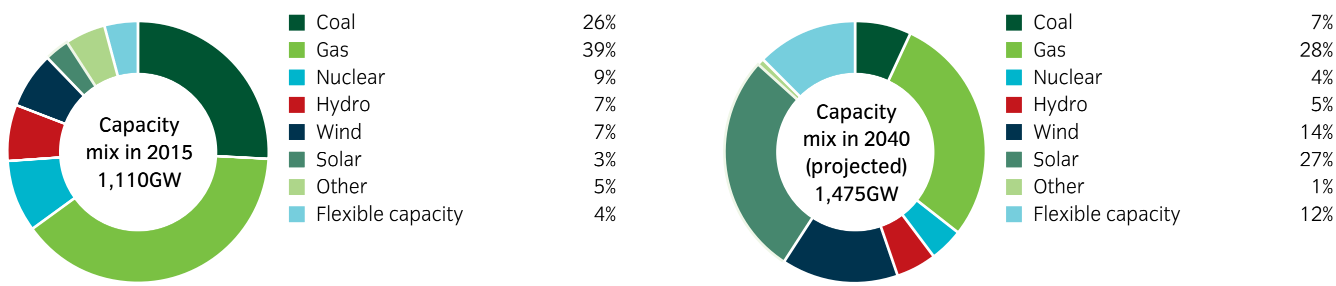
Solar and wind power are expected to comprise an ever-greater proportion of renewable energy generation. The US Energy Information Administration (EIA) projects that solar power is expected to be the fastest growing renewable energy source, with total utility-scale capacity expected to increase by 44% from the end of 2016 to 31 gigawatts (GW) at the end of 2018. Wind energy capacity at the end of 2016 was 81 GW. The EIA expects capacity additions will bring total wind capacity to 95 GW by the end of 2018. The number of jobs in the renewables sector is also booming.

Renewable energy is also being encouraged by policymakers at a state level, supported in part by federal policy. For example, in Texas, in 2005 the state legislature required 5.9GW (5% of the state's electricity capacity) come from renewable sources by 2015 and 10GW by 2025, including 0.5GW from resources other than wind. Texas surpassed the 2015 goal in 2005 and the 2025 goal in 2009, almost entirely with wind power, according to the EIA. Texas is expanding its use of biomass in the production of electricity and solar. As of July 2016, several states, including Wyoming, South Carolina, Virginia, Arizona, Idaho, and New Jersey, are moving forward to meet the CPP's requirements, regardless of federal policy.

A LONG-TERM SHIFT TOWARDS GREEN POWER

We do not believe the activities outlined in the executive order will curb the long-term decline of the coal industry. By contrast, we expect the order to give utility providers more time to invest in green alternatives, and to extend the useful life of fossil fuels. Ultimately we believe it is unlikely that companies will decide upon investment in coal as a sustainable strategy relative to cheaper and cleaner energy sources.

Figure 2: US energy capacity mix in 2015 and projected capacity mix in 2040 (GW)



Source: Bloomberg New Energy Outlook 2016. As of June 17, 2016.

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