The Mexican opportunity

InfraRed Capital Partners' Stéphane Kofman and Daniel Sausmikat discuss what recent energy reform and plenty of sun mean for renewable investments in Mexico

Q What makes Mexico an attractive market for energy transition investments?

Stéphane Kofman: First and foremost, Mexico has implemented comprehensive legislative reform of the energy sector. A key pillar of this new framework is promoting the involvement of the private sector as a key contributor to the transformation.

Of course, operating within the right regulation framework is important, but we also carried out a comprehensive assessment of the market. Through this exercise we ascertained the existence of strong and sustainable underlying fundamentals such as demand for energy. Demand has increased significantly and is forecast to continue to do so, on the back of population growth, industrial expansion and overall GDP growth. Mexico has also established ambitious clean-energy targets of 35 percent by 2024 and up to 50 percent by 2050.

All of the above factors, combined with attractive power prices, are supporting significant requirements for new power generation capacity, particularly in renewable energy.

Q Why Mexico rather than any of the other Latin American countries displaying similar market fundamentals?

Daniel Sausmikat: It's true that a lot of those fundamentals – strong demand, available land and good resources – are also applicable to other Latin American countries, but there are several key factors in favour of Mexico.

Firstly, there is Mexico's extensive track record of foreign direct investment, its prolificacy in entering investment treaties and its membership of the OECD. For us, as an investor that has traditionally operated in more developed countries, going into a new market that features not only a strong track record of being open to international investors but which also benefits from a strong business framework was very helpful.

> "The emphasis on getting involved in projects at an early stage of the value creation is in our DNA. We like to be in control of our destiny" **Kofman**

Secondly, Mexico offers significant scale compared with other Latin American countries. It has the second-largest economy and population in the region. So any market segment opening for new investments, such as the energy sector, is likely to yield a larger number and more sizable opportunities than in most of the other countries in the region.

Q Is solar the primary focus in terms of energy transition in Mexico, or are you also looking at other opportunities?

SK: We have developed a large portfolio of solar PV assets, but Mexico also has a need for a big modernisation of its existing gas fleet. We are tracking that sector closely and have already successfully invested in one of the largest high-efficiency gas facilities in the country. This new CCGT plant is currently under construction and is progressing well.

Q What stage of investment do you focus on in Mexico and why?

SK: For now, we are focusing on a value-add strategy. That means we are deploying capital targeting higher returns for higher risk on a relative basis.

This value-add strategy can either require our involvement at the development stage, participating right from the start or us acquiring assets at a more advanced stage of development.

This emphasis on getting involved in projects at an early stage of the value creation is in our DNA. It's what we have done in many markets over the past 20 years for our value-add funds. We like to be in control of our destiny.

That said, we are also tracking what's happening to projects which are already operational and generating energy in Mexico, and there may be an opportunity for us to consider those sorts of deals in the future.

What is your approach to origination and is it different in a market like Mexico?

SK: There are some differences, yes. It was very important to identify a solid and reputable local investment partner to originate and develop the assets alongside us. Having a JV with a local partner accelerated our penetration in the market. It was a way to open doors and screen a larger volume of opportunities.

In addition to working with a JV partner, we have been leveraging our global network to see how we can capitalise on our existing relationships in a market like Mexico. Finally, we also decided to dedicate our own origination resources, as we had identified Mexico as a key strategic market that deserved our time and effort in terms of systematic screening of potential investment opportunities.

Having done all that, we decided to stay away from the PPA auctions granting a 15-year power offtake contract with the state-owned utility: the former public monopoly, Comisión Federal de Electricidad. We instead focused our direct origination efforts on contracting and commercialising power to the private sector, principally large commercial and industrial energy consumers.

DS: We undertake the commercialisation effort through a separate distribution entity, which we have set up jointly with our local investment partner. In doing so, we are creating a 'route to market' for the power generated by our projects. After a relatively slow start, we gained traction with industrial clients and have been able to successfully contract most of the power generated by our projects with large industrial and commercial consumers.

What are the risks associated with investing in Mexico and how are you mitigating them?

SK: The renewables market in Mexico is still relatively immature. Many of the players – the trade operators, the regulatory authorities, the wholesale power market – and the related processes are still in their infancy. It was important for us to invest enough time and resources in working with public and private counterparties, ensuring we establish strong relationships and share similar ambitions so that we can jointly facilitate the implementation of the ambitious macro policy.

Logistics has at times also been an interesting challenge: for instance, the ports, the warehouse facilities and transport networks needed to accommodate considerable and unusual volumes of imported goods and distribute the equipment efficiently. In practice we have been pioneering logistics complexities for large-scale projects in the region.

DS: At times, it can also be challenging to find the right construction contractors or subcontractors and to find a reliable local supply of some specialist equipment. These are the challenges you would expect from operating in a nascent market with a relatively limited track record of projects of this type.

SK: Another very important consideration for our business, I would add, is the security of people and how we make sure we can enforce a strict health-and-safety policy in our projects. We spend a lot of time monitoring these risks and sharing best practice.

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Mexico has a new government, and the latest round of renewables PPA auctions have been postponed. Are there any concerns there?

SK: It is not affecting our business directly because, as mentioned above, we have developed a strategy for power commercialisation outside of the PPA auction process. But we are certainly watching these developments closely to ensure there has not been any change of heart in terms of supporting the continued deployment of new renewable energy projects. So far, we have not seen anything alarming.

DS: I would agree. There is a long history of foreign direct investment, private sector participation and overall pro-business policy and legislation in Mexico. Even though the new government is promoting a path of change, we do not think this is likely to result in a major change of the current plan for the power sector.

What does the future hold for the energy transition market in Mexico?

SK: The energy sector in Mexico will most likely face the same challenges as the ones we have seen in other global markets where limited transmission and distribution capacity eventually become a constraining factor for the deployment of new generation projects. We are well prepared for this situation on the back of what we have already been developing in Europe and the US. We are indeed actively supporting flexible generation and battery storage investments to facilitate the continued growth of renewable energy assets. ■