NXG INVESTMENT MANAGEMENT

The Next Generation of Investment Management

Energy Inflation

October 12, 2022

Rampant inflation is a result of years of (poor) monetary policy but also (even worse) energy policy globally. Investing in energy infrastructure provides the potential to benefit from short-term price increases on irreplaceable assets. Additionally, energy infrastructure will also benefit from the secular shift toward energy independence provided by renewables.

NXG Investment Management is dedicated to providing Next Generation investment strategies to investors seeking long-term growth in companies focused on a clean and sustainable future as well as traditional and transformational infrastructure companies.

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Energy Inflation from Underinvestment

In the US higher energy prices – electricity and gasoline – have averaged a +2.0% YoY contribution to CPI the last twelve months after averaging only +0.2% increases in the prior five years[1]. This 10-fold increase in the US is not an isolated problem. German prices peaked at 18x above their pre-2021 average[2]. Rising energy prices are a global problem. The secondary impacts from higher transportation, higher food costs, and decreased manufacturing capacity are also significant.

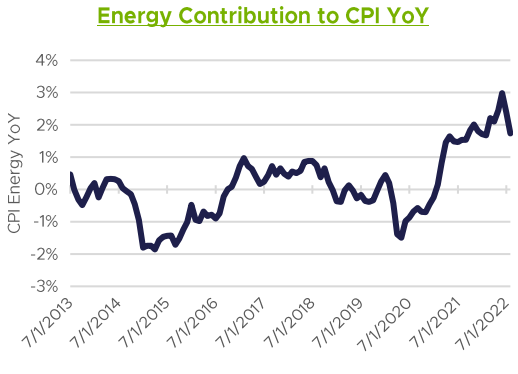
Multiple years of underinvestment in the entire energy supply chain has led to the current energy inflation. **Hundreds of billions[3] of foregone investment** is a result of both policy and market factors:

- The EU shut 21% of their coal power generation before they could build out sufficient renewables[4].
- In the US, annual utility spending on electricity generation has stagnated the last four years and is 12% below 2016 spending levels[5].
- Oil and gas investment is 28% below pre-pandemic levels[6].

Infrastructure Needed

The solution to energy inflation will be more energy infrastructure and greater utilization of the existing infrastructure. The world needs more solar panels, more electricity grid connections, and more natural gas. Investment to grow the global energy output for commodities and power will mean higher volumes for the companies we invest in. Years of underinvestment will need to be caught up and the newfound emphasis on **energy independence could mean a decade of growth in global energy infrastructure**. Renewables are the cheapest and fastest way to achieve these goals and LNG will fuel a smooth transition.

In the short term, infrastructure assets benefit from the ability to raise prices at above market rates. Some assets have high barriers to entry for competition, like natural gas pipelines. Other companies have widening cost advantage over competing technologies, like solar farms. The rate increases should more than offset any cost increases.



Conclusion

At NXG we invest in energy infrastructure companies and pride ourselves on our knowledge of company and industry fundamentals. Interest rate and FOMC prognostications are not our expertise so we will focus on the impacts inflation has for our sectors: the outlook for short term pricing and long term volume growth has expanded during the current energy crisis. We appreciate the impact that rising rates has on valuations, but we simply cannot ignore the improving fundamentals for energy infrastructure.

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[1] Bureau of Labor Statistics. August 2022
[2] Bloomberg. As of 10/7/2022.
[3] EIA. "Today in Energy" 6/13/2022
[4] BNEF. Capacity for 2021 vs 2017, data as of 10/6/2022
[5] Edison Electric Institute. "
[6] EIA. "Today in Energy" 6/13/2022

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