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Morgan Stanley Executive Sees Openings In Clean-Energy Sector's 'Missing Middle'

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A sharp decline in the value of clean-energy companies last year delivered a wake-up call to investors, many of whom harbored excessively optimistic views of the industry, according to private-equity fund managers.

As more investors in the clean-energy sector retune their "focus on fundamentals," some of the best investment opportunities can be found in companies that have developed beyond the startup stage but aren't big enough to attract managers of large industry-specialist funds, said Vikram Raju, a managing director at Morgan Stanley.

Raju leads climate private-equity and credit investing at Morgan Stanley Investment Management, the bank's $1.4 trillion alternative investment arm, and heads the firm's 1GT strategy of backing companies that aim to reduce greenhouse-gas emissions.

The strategy invested in businesses such as Huel, a U.K. supplier of plant-based food powders and meal-replacement drinks. It backed Everstream Analytics, a German business that uses artificial-intelligence **technology** to help clients make their operations more sustainable. Morgan Stanley aims to raise $1 billion for its first investment pool devoted to the strategy and collected $500 million as of May.

Raju recently discussed the opportunities he sees in midsize businesses that don't attract interest from clean-**technology** and clean-energy infrastructure funds, as well as the need for capital to revamp aging power infrastructure and meet the United Nations goal of limiting global warming to 1.5 degrees Celsius above preindustrial levels. His comments were edited for clarity and length.

WSJ: What surprised you the most about the clean-energy industry last year?

RAJU: Gravity. How quickly it became a thing. For a while it appeared that there was a collective sense of amnesia about how Climate 1.0 ended. Fortunately in 2023 we saw some of the cleantech hype dissipate and a renewed focus on fundamentals. I'll give you two examples. In venture land, cleantech startups saw the bar being raised on unit economics and scale. This has led to a record number of flat or down [funding] rounds from what were pretty hyped valuations. In infrastructure you've seen that reality present itself in hydrogen and offshore wind where again the bar has been raised and so marginal projects are treading water. Solar and onshore wind, though, have had record years, which is gratifying although let's not forget that it's taken since 1980 to get solar pricing to the point where it is today, which is 95% cheaper now.

WSJ: How do you see the outlook for climate investing in the year ahead?

RAJU: Two things: Firstly, as cleantech venture re-rates and ever larger climate funds are raised for buyouts/infrastructure, the question becomes who funds the missing middle? We see 2024 as the year of climate growth where the $40 million to $50 million check goes into companies to bridge the gap at, we think, compelling terms. Secondly, if you call yourself a climate fund you're going have to pay a financial penalty for failing to meet climate goals. The time for fuzziness is well past.

WSJ: If you had to mention one uncertainty facing investors in the energy transition over the coming year, what uncertainty would that be?

RAJU: The pace of investing will lag the actual need for capital and I'm not just talking about the 1.5 degree goal by 2050. I'm talking about large-scale shock events. Consider that 90% of U.S. electricity is currently handled by power transformers that are operating beyond their asset life. Smart alternatives are on the horizon but will not be of sufficient scale or deployment-ready in time to prevent disruption from aging infrastructure and approval processes.

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