Impact of Project Divestment on Platform Valuation
February 3, 2024
Alex Rodrigues

Summary
Renewable energy firms divest from de-risked assets to recycle capital and leverage lower cost of capital of investors. Evaluating firms that adopt this strategy with IRR inflates value estimates, offering no real insight into an investment's value creation.

Background
IRR is the interest rate where the net present value of all future cash flows equals zero. The IRR formula assumes that all cashflows generated from an investment are reinvested at the actual IRR of the investment. This dynamic is fairly understood in finance and is well illustrated in this example from McKinsey Quarterly.

The Issue for Firms That Focus on Intermediate Divestment
The intermediate divestment of ownership monetizes a project's value creation across that project's assumed useful lifetime. If the divestment itself is a transaction with zero net present value, the project's value creation remains unchanged, however its IRR will increase.

Consider a project with a $100M initial investment and an annual cash flow of $30M, a constant 6.0% cost of capital and is owned by the sponsor for the full duration of its 5-year useful life.

As shown below, the project generates an IRR of 15.2% and an NPV of $26.4M.

Long Term Ownership (no divestment)		0	1	2	3	4	5
Investment		(100)					
Project Cash Flow			30	30	30	30	30
Total		(100)	30	30	30	30	30
PV of Cash Flow							
Investment	(100.00)	(100)	-	-	-	-	-
Project Cash Flow	126.37	-	28	27	25	24	22
NPV	26.37	(100)	28	27	25	24	22

IRR	15.24%
MIRR	11.08%
NPV	26.37

Consider the same project, but with 95% divestment at the end of year 1 to a buyer at the same 6.0% cost of capital. Keeping the discount rate constant isolates the impact on the IRR.

In this divestment scenario, the IRR increased from 15.2% to 31.9% (+1700 bps) while the NPV remained constant. Similarly, the modified IRR (MIRR) also remained constant, which is a metric that assumed the reinvestment rates is held constant at the cost of capital (6.0%).

Farm down (divestment)		0	1	2	3	4	5
Sponsor View							
Investment		(100)					
Sell down / divestment		-	99	-	-	-	-
Project Cash Flow			30	2	2	2	2
Total		(100)	129	2	2	2	2
PV of Cash Flow							
Investment	(100.00)	(100)	-	-	-	-	-
Sell down / divestment	93.17	-	93	-	-	-	-
Project Cash Flow	33.21	-	28	1	1	1	1
Total	26.37	(100)	121	1	1	1	1

IRR	31.90%
MIRR	11.08%
NPV	26.37

This scenario highlights that:

- no value has been created in this divestment
- the project's NPV is merely monetized in its first two years
- IRR as an investment criterion for firms focused on divestment offers limited insight into value

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It is worth noting that this analysis is intended to highlight the limitations of IRR in assessing a firm's value in divestments and is not intended to study the value of divestment as a business strategy. There are notable benefits to intermediate divestments, including:

- capital recycling to fund a firm's ongoing business operations
- benefit from buyers with a lower cost of capital to drive higher valuations
- return of capital to investors
- showcase a firm's ability to de-risk and monetize projects

To illustrate the value of a lower cost of capital investor, consider a scenario where the buyer's cost of capital is 100 bps lower than the sponsor (6% vs. 5%).
The NPV of the project to the sponsor increases from $26.4M to $28.5M, highlighting $2.1M of value creation to the sponsor. Additionally, the IRR increased 220 bps, while the MIRR increased 38 bps.

Farm down (divestment)		0	1	2	3	4	5
Sponsor View							
Investment		(100)					
Sell down / divestment		-	101	-	-	-	-
Project Cash Flow			30	2	2	2	2
Total		(100)	131	2	2	2	2
PV of Cash Flow							
Investment	(100.00)	(100)	-	-	-	-	-
Sell down / divestment	95.34	-	95	-	-	-	-
Project Cash Flow	33.21	-	28	1	1	1	1
Total	28.54	(100)	124	1	1	1	1

IRR	34.10%
MIRR	11.46%
NPV	28.54