

MAKING WAVES IN ENERGY

High oil prices and global warming are casting a spotlight on renewable energy
– but are decent returns available, or is it all just hot air?

By *Laura Latham*

EVEN DIE-HARD oilmen must be sensing the winds of change. Supplies of oil, coal and gas are running low and becoming increasingly costly, with oil prices recently hitting an all-time high. In addition, carbon dioxide from fossil fuels is considered a major contributor to climate change, leading to worldwide calls for increased development of alternative power sources.

Once seen as a niche market, renewable energy is gaining strength among multinationals and investment firms. Oil giants such as BP and Chevron have created subsidiaries to explore the possibilities in wind, solar and hydropower, while managed funds investing in such technologies have been launched by almost every big-name finance company.

Governments, keen to start meeting targets on reducing carbon emissions by 2020, are also offering financial incentives to encourage interest in renewables. Companies in Ireland, for example, can currently invest up to €12.7 million per annum in alternative energy projects and claim tax relief on the equivalent amount.

“There’s a lot more interest now in renewable energy,” says Alex Connor, fund manager with Triodos Bank, which was one of the first to enter the alternative and ethical sector in the 1980s. “Five years ago there was a lot of uncertainty surrounding alternative energy but now the market is more stable and predictable, plus there are more investment opportunities.”

Triodos runs managed funds that invest in alternative power but also owns a number of operations, including wind farms and marine technology firms. Connor believes that, of all the sustainable sources, wind currently offers the

most potential for growth. “Wind power is sustainable and profitable,” she explains. “It’s a long-term technology and there are strong prospects.”

Having said that, returns are steady but not exactly stellar. “Anyone who bought in our last share issue in 2005 would have seen a seven per cent return in dividends and growth,” says Connor. She agrees that this may be fine for those who want to feel good about where their money is going, but it won’t necessarily attract anyone who wants the kind of returns other commodities might offer.

However, she points out that Triodos is offering a stable platform that isn’t listed and so, doesn’t fluctuate according to market vagaries. In addition, as the sector becomes more prominent and the development of technology gets cheaper, Connor fully expects to see valuations of renewable energy companies rise.

Anyone investing in renewable energy needs to see it as a long-term strategy, according to Richard Power of Dublin-based Dolmen Securities. The company’s Green Effects fund has been running for eight years, yet Power still refers to the industry as a “niche opportunity.”

Dolmen’s fund invests across companies working in the renewables field including hydro, wind and solar energy. Power considers the latter to currently be the largest sector. “Solar energy has a bigger market capitalisation,” he says, “but wind is closing on it.” He cites the performance of companies such as Vestas, which manufactures wind turbines, as “remarkable.”

Returns from the Green Effects fund have varied considerably, with gains of over 20 per cent in 2005 and

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2006 down to 6.43 per cent last year – the lack of growth since January appearing to mirror the volatility of the global economy.

However, Power claims the sector is attracting more serious players. “Three years ago investors were primarily green-focused,” he says. “That has changed massively.” His views are backed by the actions of big business, which is moving in on the renewables market.

Last year, Irish wind company Airtricity sold its US operation to German firm E.on for €1.4 billion. In January, the rest of the company was bought by Scottish and Southern Energy for €1.8 billion. National Toll Roads’ (NTR) chief executive Jim Barry, a majority shareholder, said he sold because Airtricity needed the backing of a heavyweight utility firm in order to grow, not because he had lost faith in the sector. In fact, Barry said NTR would be looking into other areas of renewable energy, including solar and biofuels, and wasn't ruling out a return to wind.

It seems that all over Europe, companies are realising the prospects this sector can offer. Especially for those getting in early. One such firm is EnerCap Capital Partners, which has raised funding for green energy projects across central and eastern Europe with investors that include the European Bank for Reconstruction and Development and Ireland's Jaguar Capital.

“The idea is to finance projects that will begin yielding revenues within the next three to four years,” says EnerCap's project finance partner Shane Woodroffe. “Eastern European countries are less energy-intensive than western Europe. However, their economies are growing rapidly and they still have to meet EU carbon reduction targets by 2020.”

EnerCap works with all forms of renewables, including hydropower. Woodroffe claims this has the longest track record of all sustainable energies but is now largely ignored in favour of wind and solar, due to the vast scale of hydro

projects and the environmental concerns linked to building dams and diverting rivers.

His company is evaluating the creation of mini-hydro plants producing power using the flow of rivers, which Woodroffe admits, “has limited application and needs a long time-frame.” However, as an addition to other forms of energy he believes it has some value.

Despite the possibilities in many countries to run large-scale solar systems, Woodroffe sees solar energy lagging behind wind by several years and claims it is more expensive to run. However, he expects costs to drop as more money goes into development.

For the best returns, Woodroffe would place bets on wind. The cost of producing electricity this way has dropped dramatically over the past few years and the technology is better understood and easier to implement. “Wind is well proven and has a good track record,” he says.

In addition, he points out that governments are seeking a way to ease their dependency on fossil fuels, which are becoming increasingly costly and politically sensitive. There is also the issue of the unpredictable global economic situation that Woodroffe thinks will encourage people to look at this sector. “Investors like renewables because they aren't tied to economic cycles. For example, the effects of a recession won't necessarily tie in with a poor wind cycle.”

EnerCap is aiming for big, institutional investors attracted by the company's target internal rate of return of 25 per cent, but Woodroffe thinks those with less to invest are best off in a managed fund that can diversify risk across a variety of renewables. He also wouldn't advise anyone to plunge all of their capital into the sector just yet.

“Renewables definitely have their role to play but will always be niche, they are never going to take the place of traditional energy.”