

Sound case for going 'green', FT article by Ian Simm

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Ten years ago environmental investment management was seen as the preserve of the ethically minded – an honourable trade, but not a profitable one. When stock market valuations of some renewable energy companies fell after the internet bubble burst earlier this decade, the appeal of “green” investment was further dented.

But since their nadir in 2002, environmental markets, like the digital economy, have rebounded with a vengeance. Indeed, they represent one of the few areas where investors are enjoying relatively predictable returns on the back of strong growth and long-term potential.

For example, the wind power industry has grown by more than 20 per cent per year over the last five years. The solar power industry has seen annual growth rates of more than 30 per cent. Water and waste markets are growing at double digit rates annually. What is behind the change?

As traditional energy, water and waste industries have been shaken by liberalisation and privatisation, innovation and falling technology costs have made environmental products and services more competitive.

High commodity prices and a tightening ratchet of environmental policy are providing a further boost to nimble companies with incentivised management teams able to quickly develop and provide environmental solutions.

Perhaps the most significant confirmation of these trends is that large companies such as GE and Siemens are beginning to position themselves as environmental market leaders. General Electric has bought a half dozen specialist environmental businesses recently, including Jenbacher (an off-grid power supplier), Osmonics and Ionics (both water purification companies). Late in 2004, Siemens bought Bonus (a wind turbine manufacturer).

Initial public offering activity also underlines the growth of environmental markets.

The number of renewable and environmental companies listed on London's Alternative Investment Market has nearly trebled in the last two years, as more institutional investors show an appetite for environmental stocks. But suspicion still lingers: are environmental markets a flash-in-the-pan dependent on government support? Will regulations be watered down or withdrawn?

The overwhelming evidence is that regulations are more likely to be extended and they are by no means the only market drivers.

There are compelling arguments for targeted regulation. In the energy sector, renewable power can be produced from local energy sources and thereby increases security of energy supply. Recognising this (and other benefits), the European Commission has mandated that 12 per cent of energy be sourced from renewable sources by 2010. Given the likelihood of high long-term oil and gas prices and political instability in some oil- and gas-producing regions, governments all over the world are providing support to renewable power generators or introducing regulations to ensure utilities buy renewable power.

Government regulation and subsidies are only part of the environmental markets picture. The rising costs of conventional energy and of commodities are increasing private sector demand for technologies that enable efficient use of resources.

A doubt raised over renewable power by some proponents of nuclear energy is that renewables are not a big enough or mature enough industry to take on the challenges of climate change. Having nuclear power and renewables together in the energy mix is certainly possible. It is not a question of either/or.

But it is in environmental markets where growth is strongest, where investor interest is booming and returns are highest.

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