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Buyout groups struggle to invest to save the planet

In the second part of a series on how green issues are affecting the private equity industry, Catherine Craig looks at the challenges facing large buyout groups

In spite of Sir David Walker's admonition in his review of the private equity industry published last week that legislation requires company directors to pay regard to "the impact of the company's operations on the environment", large buyout firms trying to invest in assets that are environmentally sustainable face big challenges. Opportunities to put money into mature companies with a green agenda remain sparse, say industry specialists.

As a result, few mainstream private equity firms have a co-ordinated green investment strategy, where they may be susceptible to interest-rate fluctuations and legislative uncertainty, according to research by Financial News. Most firms say their priority lies with generating returns to investors, not saving the planet.

In the UK the Kyoto protocol, discussions on which began in 1997, has resulted in commercial opportunities in the renewable energy sector to reduce carbon emissions. The Carlyle Group recently backed Ensus Ethanol, a wheat-based bioethanol plant in northern England. But 3i, the listed private equity group, which leads by value in renewable energy according to research firm New Energy Finance, invests only on an ad hoc basis in venture and buyout opportunities in the sector.

There are few UK buyout funds that invest in mature renewable energy companies. Research group Private Equity Intelligence lists only one such fund – HgCapital – that specialises in clean technology investment. Its €300m ($414m) renewable energy fund, Renewable Power Partners, was raised last year by Tom Murley, a lawyer with investment experience in renewables. The fund invests mainly in mature European wind energy projects. Ian Armitage, chairman of HgCapital, said: "We set the fund up for our existing investors looking to hedge against inflation as well as new investors looking for exposure to low carbon economies. Hg substantially invests in proven technology; it has no interest in investing heavily in technology that is not tried and tested."

Thomas Rottner, a director with Platina Finance, which owns the UK's largest onshore wind farm at Burton Wold near Kettering, said: "On assets only, we expect targeted returns of about 12%. Developed infrastructure assets tend to be safe but you can inject a bit of excitement into returns by putting a small portion of the fund into development." For this reason, Platina invests in early-stage wind technology and wind farm development projects and has achieved an internal rate of return of 30% on its early stage fund. Hg also invests in wind power development projects in Europe on which it has first refusal once the plants are set up.

The disparity between investment in mature clean-technology opportunities and venture investment is borne out by the fact that private equity investment, including buyout and growth capital, fell in the first half of this year to $3.2bn, while venture capital investment rose to $5.4bn, according to New Energy Finance.

European venture capitalists have seen the merits of investing in clean technology and made an average return of 87% a year on venture investment in low carbon technologies since 1999, according to New Energy Finance. Apax Partners made one of the best venture returns in Europe when it floated solar energy specialist Q-Cells on the Frankfurt Stock Exchange last year, achieving 27 times its money on a investment of €11m over two years.

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But investing directly in sustainable companies, whether in the renewable energy sector or elsewhere, may prove a red herring.

Forum for the Future, a non-government organisation which lobbies businesses to use sustainability to their commercial advantage, published a paper at the European Private Equity and Venture Capital Association's annual conference last year, suggesting that buyout houses could raise their profile with government and the public by acting and investing sustainably and find cost efficiencies through their own portfolios of companies.

The report said: "Where the private equity investor is seeking to grow a company over the medium term, then an integrated sustainable development analysis may add value."

It suggested improving energy efficiency in portfolio companies by saving on water and other resources; undertaking an environmental audit to ensure that environmental compliance standards can be met or improved upon, and better supply chain management as a way to save on environmental and economic costs.

Next week: investors' appetite for green energy

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