

Financial News

Venture capitalists lured by alternative power

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Diversification of renewable energy portfolios is needed to combat investors' uncertainty about the sector

The move last week by former US Vice-President Al Gore into climate change investment highlights the growing urgency for investors to become serious about global warming. Gore joined US venture capital firm Kleiner Perkins Caufield & Byers to support its investments in clean technology.



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Concerns that the rush to invest in opportunities in clean technology may cause a bubble are offset by growing evidence that this risky area is underinvested and undermined by fears of a dotcom-style collapse.

New Energy Finance, a provider of information and research to investors in renewable energy, low-carbon technology and the carbon markets, reported that private equity and venture capital investment in clean-energy companies in the Americas, Europe, the Middle East and Africa rose by 50% to \$11.9bn (€8.1bn) in the third quarter this year, compared with the same period last year.

Alice Chapple, director of sustainable financial markets at development organisation Forum for the Future said: "In the context of what's needed from technologies to stop CO2 emissions, only a fraction of the money required to combat the effects of climate change are going into the sector."

To assess the viability of clean energy, Forum for the Future is sponsoring the London Accord, a set of research reports from blue-chip organisations outlining the optimum types of investments in clean technology. The report will be published next month.

Rowan Taylor, managing partner at US firm Oak Hill Capital Management, believes the private equity industry will be particularly interested in evaluating investment opportunities in the sector.

Oak Hill has acquired Firth Rixson, a UK aero-engine component maker that is developing manufacturing capabilities for wind turbine parts, from buyout group

Carlyle.

The deal highlights the dilemma faced by investors considering a diversified and economically sound portfolio, which takes clean technology into account.

The London Accord is designed to help investors target the correct destinations for green capital, given that it is unlikely a primary source of clean energy will become available.

Financial News examines four sectors in which investors are looking for returns.

Wind: least risky

Wind power accounts for 5.5% of energy produced in Germany and the UK is targeting up to 10% of electricity production to come from renewables, with wind at the forefront, by 2010. Citigroup analysts said in May the best jurisdictions for investment were those with regulated feed-in tariffs attached to wind energy, including Spain and Italy.

Wind power is an area in which buyout groups are proving their success. UK private equity firm HgCapital has most of its €300m (\$439m) green investment fund – the largest of its kind in the UK – invested in wind projects.

The firm's investments cover building projects and expansion, and include ReWind, an Italian wind farm developer. HgCapital is confident in the sector and has created the largest team of investment staff in the UK dedicated to green technology after making senior appointments in September.

Platina Finance, a private equity fund investing in renewables with more than €200m under management, is the owner of Britain's largest onshore wind farm, Burton Wold in Northamptonshire. The group combines infrastructure investment with early stage development projects, achieving returns of more than 30% on its venture funds, according to investor sources.

Thomas Rottner, managing director at Platina Finance, said: "Developed infrastructure assets tend to be safe but you can inject a bit of excitement by putting a small portion of the fund into development." This approach is employed by others, including HgCapital, which is mixing early development risk into more developed assets to boost typical targeted returns of 12%.

Widely considered to be the least risky type of green investment, wind turbine projects rely on an inexhaustible, freely available natural resource. Mortimer Menzel, partner at UK advisory boutique Augusta, said: "Wind is a free natural resource and often wind turbines are carbon-neutral after about five or six months of operation.

"Offshore wind generation is one of the most intelligent places to invest right now. There are serious wind resources offshore where bigger turbines can harness wind without the visual or auditory impact that onshore projects may have."

Investors can also capitalise on the opportunities in the manufacturing of components

for wind technology. According to Morgan Stanley's Clean Energy report published last month, a shortage of components is a key issue.

UK mid-market firm Gresham Private Equity this month launched an investment team dedicated to energy and environment investments. Gresham is looking at support services and manufacturing businesses.

Solar: biggest attraction

Despite perceptions that wind is one of the more stable green investments, solar power has attracted the biggest portion globally of venture capital and private equity investment. According to New Energy Finance, solar gained the highest number of investments in the US with 72 deals worth \$971m in the year ended October 2007.

In the US, venture capitalists are the biggest investors in solar power whereas in Europe private equity has shown most interest, with \$732m dedicated to the sector, according to New Energy Finance.

The WilderHill New Energy Global Innovation index reported this month that solar stocks were the strongest performer, gaining 25% in the third quarter of this year. New Energy Finance attributes this growth to the continuing shortage of silicon.

However, industry specialists are wary of the apparent health of the sector. Menzel said: "The killer argument as to why photovoltaics is not that viable is that the equity returns on solar projects are typically much lower than those for wind.

"Germany, for example, has seen returns of 5% to 6%, whereas wind projects can be at least double that. The basic technology is over 20 years old and there has been little competition between solar panel manufacturers until recently, which has kept panel prices high."

Morgan Stanley predicted in its October report that solar power would become cost effective without government subsidies but that the near-term market was likely to experience volatility if there was a decline in subsidies, which the industry has been "highly dependent on".

James Allen, clean energy analyst at London Bridge Capital, said: "Some solar companies are coming to market at high multiples at the larger end of the industry – in some cases valuations are much too high.

"The current installed cost of capacity for solar power is three to five times the cost of coal or natural gas, so it would be far from being commercially viable if it were not for the fact there are government subsidies."

Biofuels: less enthusiasm

The European Union expects 5.75% of its transport fuel to come from biofuels by 2010.

According to calculations by Financial News, even if the UK was covered with plants

producing rapeseed oil, which is generally regarded as the most efficient feedstock for producing biodiesel, it would produce only 29 million litres of biodiesel.

This would be insufficient to serve the country's 26 million cars, which use on average 1,500 litres of fuel each a year.

Menzel said: "Some green technology projects can be subject to double market risk. Biofuel plants, which buy rapeseed or palm oil at market rates, process the organic matter to produce electricity, which is sold at market rates. There is a risk of price fluctuation."

Similarly, bioethanol projects, which rely on starch in wheat to produce fuel, have been hit by record wheat prices. Canada and Australia, two of the world's biggest wheat producers, have been hit by unfavourable weather, which has reduced yields.

According to research by New Energy Finance, the biofuels sector is experiencing "less enthusiasm" for raising expansion capital as well as "margin squeeze". It also found venture capital and private equity investment in the sector globally to have almost halved to \$227m in the third quarter compared with \$602m in the first quarter.

The fall has come despite rising oil prices and amid a backlash of public opinion because of the side effects on developing countries, said New Energy Finance.

Parts of the rainforest in the Amazon and South-East Asia are being cleared for biofuel crops, including palm oil and sugar cane, which are used to produce ethanol. Morgan Stanley's report said the second generation of more efficient biofuels would come to market in about five years.

Efficiency: logical next step

Investors need reassurance to strengthen their portfolios and nerve going into the green sector. This can be achieved by logical investment in energy-efficient technologies, according to industry analysts.

After solar, wind and biofuels, energy-efficient technologies accounted for the largest amount of investment in Europe, the Middle East and Africa in the third quarter this year, according to New Energy Finance. Chapple said: "Where investors can perhaps add stability and a clearly effective piece of investment is in companies which promote energy efficiency."

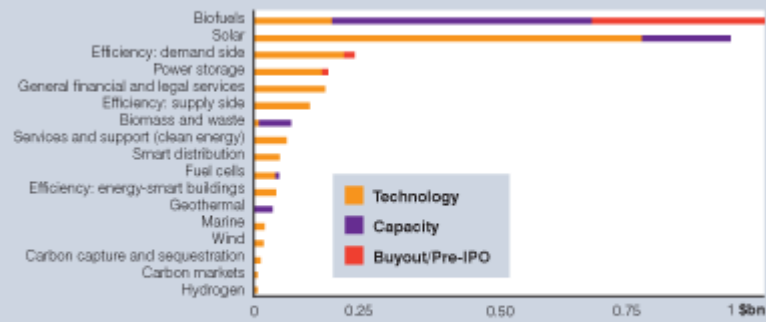
Conclusion

The message to investors seems to be based on diversification rather than focusing on a single asset, taking into account wind, solar, biofuels, carbon capture, energy storage and efficiency technologies.

•This is the latest in a series of articles in Financial News on global warming. The features will culminate in a timetable of lunches next month. Attendance at the lunches is limited. Individual ticket applications may be made to:
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Graphic

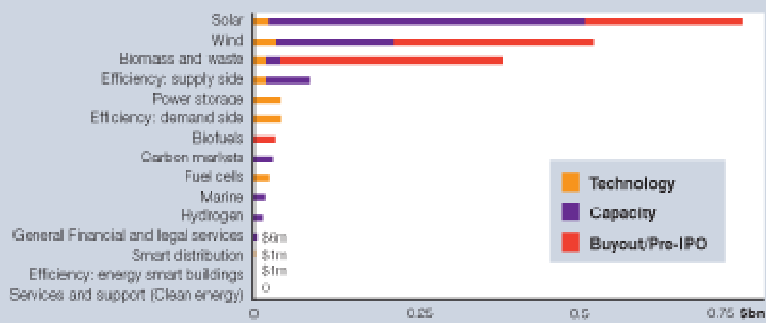
Americas venture capital and private equity green investment by sector Q4 '06 – Q3 '07



Note: Deals included from Q4 2006 through Q3 2007. Private equity for projects, PIPEs and OTC deal types are excluded. Excludes deals where amount is not disclosed.

Source: New Energy Finance

Emea venture capital and private equity green investment by sector Q4 '06 – Q3 '07



Note: Deals included from Q4 2006 through Q3 2007. Private equity for projects, PIPEs and OTC deal types are excluded. Excludes deals where amount is not disclosed, such as EMEA buyout deal

Source: New Energy Finance