

Eco-Investing on the ASX.

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'Eco-investing' is a very grand term and it may feel as though one should be a fully fledged 'eco-warrior' to even consider such a drastic investment strategy. The truth however is that with a little bit of research, it is easy to find a good number of companies that base their businesses on making money from doing environmental good. That's not to say that every company claiming environmental benefits is a good investment – far from it as we will see – but there are plenty of options available for investors of all risk appetites.

Depending on your definition, there are at least 75 companies listed on the ASX that have an environmental focus. These are companies with the majority of their revenue (or future revenue in many cases) comes from an activity such as renewable energy (wind, solar, geothermal etc), water technologies, waste management and recycling, energy storage, vehicle technologies, environmental services, biofuels or carbon.

Some definitions of the sector also include companies with activities in 'cleaner' fossil fuels such as natural gas, coal seam methane, 'clean' coal technologies or even uranium. This opens up another swathe of companies to look at. Expanding the definition further might include larger companies that have only part of their operations in environmentally focussed activities. This might include companies such as Origin Energy and AGL, which are primarily fossil fuel companies with some renewable energy operations.

Drivers of Growth

There have been discussions in some parts that the 'cleantech' sector is just a 'green bubble' similar to the tech-bubble. The growth of this sector is however underpinned by four key and strong macro-economic drivers that will ensure its longevity.

- There are many tangible assets being constructed to provide core services such as power, water, waste and recycling.

- The demand for these core services and for reduced impacts on the natural environment is growing due to both population growth and increasing wealth.
- As the world continues to use and deplete its natural resources there is increasing pressure on communities to adopt cleantech solutions to increase efficiency and decrease waste.
- There is the recognition of climate change and consequent regulatory regimes. This is a separate driver from those above and, whilst it will result in additional growth in some cleantech sub-sectors, it does not underpin the cleantech sector as a whole.

At a more local level, revenues for Australian cleantech companies will grow from increasing demand from industrial companies. This demand is being driven by two issues:

- Larger companies are facing increasing regulatory pressures to report on and reduce their environmental impacts. This not only includes emissions reporting that publically show their greenhouse emissions profiles but there are a multitude of other environmental regulations regarding air quality, effluent standards, impact on native vegetation and reduced water availability that are driving companies to seek more resource efficient and less polluting technical solutions.
- Companies are also starting to face supply chain pressures to both report on the environmental impacts of their operations and strive to reduce this footprint. In Australia, Reputex is now analysing and reporting on the supply chain emissions of all ASX200 companies and this will increase this focus.

Risk Appetite

One of the often misunderstood characteristics of eco-investing is that it does not just include speculative investments in technology start-ups that are years from revenue. Other companies that fall into this category include large waste and recycling companies such as Sims Metal Management and Transpacific Industries, infrastructure owners such Transfield Services Infrastructure Fund and water industry equipment supplier, the Crane Group. All of these examples provide more mature,

less volatile investment opportunities. There are of course plenty of highly speculative geothermal, solar, recycling and carbon companies that offer the potential of higher returns. Some of these risky companies have the potential to be world leaders and this may be of interest for the speculative investor.

The sector therefore offers something for everyone. As with all stocks however it is essential to research the companies you are looking at. There are companies that have the best environmental credentials that might not have sound commercial principles. There are others however that have will deliver both environmental and economic benefits.

Performance

There are a number of indices that track the performance of Australian stocks and their relationship with carbon and the environment in general. The ACT Australian Cleantech Index provides one of these views. It tracks 76 companies with a total market capitalisation at the end of December 2009 of \$10.5 billion. The index is split into a number of sub-sectors, each of which has its own sub-index.

The sub-indices provide some clues as to which sub-sector is currently in favour. The geothermal sub-index for instance, saw massive (>200%) growth in FY07 and after decreasing for two years stabilised in the first half of FY10. The solar sub-index grew by 87% in FY09 but then fell 17% in the first half of FY10. These rises and falls provide a good platform for understanding the market dynamics of the sector in general.

Overall the ACT Australian Cleantech Index increased by 43%, more than the Small Ordinaries, in FY07 and fell by 16%, less than the ASX200, in FY08. In FY09 however it fell by 39%, more than both of these benchmarks. The story has got worse over the first half of FY10 with the recovery experienced by most of the market bypassing most of the larger cleantech stocks. This may indicate that there is currently good value to be had in the sector or maybe it just shows that the sector is still fairly immature and is not yet fully connected with the market.

The strength of the macro-economic and demand-side drivers behind the sector provides the foundations for long term growth and the wide variety of companies now listed on the ASX presents current opportunities. Eco-investing therefore offers a

range of sound investment options for all investors with the common thread that the investee companies are all working towards both investor returns and environmentally positive outcomes.

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