What's Wrong with Cleantech?

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This should be the time when the cleantech stocks start to significantly outperform all other stocks. It should be the time that those that have been investing in the sector finally get to say 'I told you so!' So why are the cleantech stocks in Australia faring so badly?

There are certainly some issues that have had clear impacts on those companies that need a strong, or indeed any, carbon price. The Australian Emissions Trading Scheme, or whatever it may be called in the end, is delayed and highly uncertain and the outcome of Copenhagen was even more underwhelming than the predictions. If you are a company getting ready to make money from a mandatory carbon market in Australia, there is still a little while to wait.

But there appears to be plenty of good news: the Renewable Energy Target is driving wind farms, although it is maybe driving solar hot water systems harder at this stage; the photovoltaic industry continues to thrive and is looking at further reductions to their supply costs in 2010 according to an upcoming report from the Clean Energy Council; and supply chain pressures are starting to build on the larger industrial companies with the publishing of the first NGERS figures and with analysis from companies such as Reputex that have analysed the supply chain emissions for the ASX200 companies. Even environmental standards in water, air quality, engine performance and recycling all seem to be creeping up, which should be driving the adoption of cleantech products and services.

There is undoubtedly the feel that the cleantech industry is growing quickly and that many are starting to generate good revenues with healthy margins. The public measure of cleantech, the ACT Australian Cleantech Index, is however having an appalling run. So where is this disconnect?

The ACT Australian Cleantech Index tracks 76 listed companies that generate the majority of their revenue (or future revenue if they have none) from defined cleantech activities. At the end of December 2009, the combined market capitalisation of all the constituents was A$10.5 billion, falling from its peak of $16.3 billion in July 2007. In FY07, the Index increased by 43%, more than the Small Ordinaries, and, in FY08, it fell by 16%, less than the ASX200. 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.

Over the first half of the 2010 fiscal year, the ACT Australian CleanTech Index recorded a loss of 4.9%, compared with the 24.3% gain by the S&P ASX200 and the 26.7% gain by the S&P ASX Small Ordinaries.

The best performer of 1HQ FY10 Eco Quest Ltd, whose share price gained 189%. Other good performers, all of which had gains in excess of 50%, were Solco, Enviromission, Advanced Energy Systems, WHL Energy, Mission NewEnergy, Dolomatrix, Stericorp, Pro-Pac Packaging, Traffic Technologies, Gale Pacific, CBD Energy, Revetec, Greenearth Energy, Carbon Conscious, Pacific Enviromin and BioProspect.

Those that performed poorly with losses of greater than 50% over the first half of the year were Hydrotech International, Skydome Holdings, Pacific Environment and Jackgreen.

A closer analysis of the index performance shows that, whilst many of the smaller stocks have recovered quicker than the general market, the larger cleantech stocks such as Sims Metal, Transpacific Industries and Infigen Energy have not recovered as quickly. This has been the primary cause of the Australian Cleantech Index being left behind.

The sub-indices provide some further clues to this performance. The stand-out sub-sectors for the six months to December 2009 were the catch-all ACT Efficiency/Buildings/Biomaterials/Energy Storage/Fuel Cells Index, driven by strong performance by a number of different small stocks, and the ACT Biofuel Index, driven by the recovery of Mission NewEnergy.

The worst performer was the ACT Solar Index, driven by the 45% decline in the Quantum Energy share price over the period. Another poor performer was the ACT Waste Index, which contains some of the largest stocks (Sims Metal Management and Transpacific Industries).

So what does this all mean? Why isn't the Index chart looking like the predicted 'hockey stick'?

I think the recent results tell two stories. Firstly, and probably more reliably, it shows that the listed cleantech sector is still relatively small and immature. That the few larger companies have underperformed, generally for very specific reasons, has significantly impacted the whole index. If there were more, larger companies, then these isolated underperformers would not have such an impact.

Secondly, and maybe hopefully, the recent underperformance of the sector indicates that there is currently good value to be found in some of the stocks. 2010 is likely to see the listing of a number new cleantech companies, including at least one from China, as well as the recovery of some of those that have been slow to come back, so maybe this will be the year of the 'hockey stick'.

The fundamental drivers of cleantech are unchanged, despite the delay in some of the carbon related schemes. It therefore feels just a matter of time until the performance of the listed cleantech sector reflects this promise.

I look forward to writing about how 'I told you so' in this column in January 2011.

John O'Brien is Managing Director of Australian CleanTech, a research and broking firm that provides advice to cleantech companies and financial institutions. Australian CleanTech publishes the ACT Australian CleanTech Index