

INVESTING



An Introduction to
Sustainable Investing

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Green has never been a more popular colour for today's savvy investors. Not so many years ago, investing in the environment was something for fringe investors: the preserve of long-haired, bearded men in woollen jumpers.

Today, the only long hair, beard and jumpers in sight are those of Sir Richard Branson, who, in autumn 2006, announced that the Virgin Group would be investing £1.6 billion in renewable energy over the next ten years.



Huge Opportunities

The involvement of Branson, not to mention a whole range of corporate and institutional investors, is confirmation that the whole sustainable investment arena, encompassing sectors such as renewable energy, clean technology, recycling, biofuels, waste management and energy security, is now widely recognised as an area of huge investment opportunities.

Far from being the niche investment area it once was, these opportunities are attracting seasoned investors from across the spectrum. In September 2006, British Gas owner Centrica invested a considerable sum into a green energy fund developed by UK investment bank, Climate Change Capital. Several large utility groups, like Scottish Power and General Electric, have pumped millions into wind power, as has the 'Sage of Omaha', Warren Buffet, through his Berkshire Hathaway subsidiary, MidAmerican Energy. Oil majors such as BP and Shell are investing heavily in alternative energy sources, while at a high street level blue-chip names such as Boots and Marks & Spencer have committed themselves to more sustainable packaging policies. BSKyB has become carbon neutral, invested in a wind farm in New Zealand and made the environment central to its corporate responsibility policy.

Even President George W. Bush, a former Texan oil man, has endorsed resource efficiency. In his State of the Union address in January 2006, he warned that "America is addicted to oil" and pledged to seek a 22% increase in funding for clean energy research.

On the back of such attention, Clean Edge, a US-based green technology consultancy, estimates that the four core sustainable energy technologies of biofuels, wind power, solar energy and fuel cells were worth US\$40 billion in 2005 — and could grow to a colossal US\$167 billion by 2015.



Small Cap, Big Gains

There are already several dedicated funds focusing on opportunities in the sustainable investment sector, including products from City stalwarts such as Jupiter, Merrill Lynch and New Star. Generally these funds are aimed at quoted companies operating in the international marketplace, a market which is already crowded.

One alternative still largely overlooked by most fund managers is to invest in unquoted UK companies operating in the domestic market. By staying in the UK, investors can develop a better understanding of the market and its drivers and gain confidence from the transparent and tightly regulated legislative regime under which companies operate. Moreover, it eliminates the currency and country risks inherent in international investments and allows companies and shareholders to work with the progressive and favourable tax regime in the UK.

A focus on unquoted companies maximises the potential for higher returns by getting investors in early in the company's growth cycle. Selecting only the most robust, UK-focused, unquoted companies, enables investors to take advantage of the considerable growth that often occurs pre-flotation. And by being involved in companies from unquoted to IPO status, investors can benefit from the rapid growth of a 'hot' sector — as sustainable investment appears to be. By the time most other funds are looking to invest, early-stage investors have already made their returns. They are also better placed to take advantage of the tax benefits of investing in early stage sustainable companies, such as Enterprise Investment Scheme (EIS) tax breaks.

A number of funds have recently launched specifically focusing on this end of the market. They include a venture capital offshoot launched by the Carbon Trust, the Government quango charged with promoting investment in green energy; a low carbon fund backed by a £20 million investment from ABN Amro; and the Sustainable Investment fund which has been launched by Foresight Venture Partners in November 2006, which will focus on unquoted growth situations in sustainable markets in the UK.

Opportunities in the sustainable investment market encompass a wide range of sectors, each with their own strengths, development drivers and growth potential. However, the core sectors with the best short to medium-term investment potential are widely identified as:

Biofuels and Biomass

Biofuels are produced from plant material and used as liquid fuel replacements for diesel and petrol in vehicles. Biodiesel comes from vegetable oils such as oilseed rape, while bioethanol comes from starch-based products, such as wheat or sugar beet. The EU has a mandatory target of 5% of all road transport fuels to come from renewable sources by 2010, a target transposed directly into the UK with the Renewable Transport Fuel Obligation (ReTFO). Experts expect up to 25% of all fossil fuel usage to be replaced by biofuels in the not too distant future.

Biofuel investment opportunities include everything from suppliers of the processing technologies and equipment, through the logistics of distribution, to manufacturers of biofuel energy systems, and the services on which they depend.

Allied to biofuels is biomass technology. This generates energy from specially grown crops, such as elephant grass or coppiced willow, or crop residues, such as straw.



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Renewable Energy (wind and solar power)

Wind and solar power are the sustainable energy sources with which many people are most familiar. The wind sector includes components and subassemblies for wind turbines, as well as manufacturers of turbines themselves. A big part of the sector, however, is the various developers, generators, utilities and engineering firms that are involved in wind farm developments around the world.

The solar sector covers all technologies that capture energy directly from the sun. It is already a substantial market and cost reductions through new technologies or through increased manufacturing scale should see it breaking into new areas of energy demand over the coming decades. Technologies that address solar grade silicon shortages are gaining particular attention.

Waste-to-Energy and Recycling

The UK has the highest proportion in Europe of waste going into landfill. This is not sustainable, both because sites are scarcer and because landfill taxes make it an ever more expensive method of waste disposal. This combination of factors is driving developments in the recycling and waste-to-energy sectors.

Waste-to-energy technology enables the processing of certain wastes (e.g. sewage waste, chemical by-products and some municipal waste) to produce energy. It is already a sizeable business. US consulting firm Frost & Sullivan reported that that European waste-to-energy plants earned US\$1.8 billion in 2005. It estimates this to reach US\$2.7 billion by 2010.

For waste that can not be converted to energy, the emphasis is on recycling and making more sustainable use of the waste. The Government is committed to significantly decreasing the amount of waste sent to landfill, in accordance with European Directives.

Clean Technology

Clean technology includes fuel cells, regarded as the most likely successor to oil. These have the potential to produce unlimited supplies of clean energy with little practical downside.

Often linked to fuel cell technology is hydrogen, which covers everything from the production and storage of hydrogen, through its distribution and the various technologies and applications for it. Hydrogen is not in itself a renewable fuel source. It is only a carrier of energy, like electricity. But if produced renewably, hydrogen (in the form of hydrogen fuel cells) is another strong candidate to replace fossil fuels in transport.

Clean technology also covers power storage. Batteries and other energy storage technologies are key facilitators for a shift to sustainable energy technologies.

Another clean technology, geothermal power, is benefiting from recent technological advances which could see it playing an increasing role worldwide in coming years.

Sustainable investment is going to experience considerable and continued growth in the future. With progressive government policies, favourable tax regimes and wide scope of investment opportunities, sustainable investments can offer an attractive option for the green investor.

For further information on Foresight Venture Partners' Sustainable Investment fund, or on investment opportunities in the environmental sector in general, do not hesitate to give James Armstrong a call on 01732 471815 or email jarmstrong@foresightventurepartners.com.



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Solid Foundations

The boom in sustainable investment has drawn parallels with the hi-tech boom of the late 1990s, when billions of pounds were invested in fledgling companies peddling untried technologies of dubious promise. But the comparisons appear misleading. The dot com boom was a short-term speculative gamble on technologies that were themselves unproven, and for which there was no proven market. The drivers of the sustainable investment sector are considerably more robust — and more compelling. Consumer and corporate demand, supported by EU and Government directives, has created investment conditions that will handsomely reward the companies and investors that deliver green solutions to the market. Indeed, investments into areas such as recycling and renewable energy could be viewed as the utilities of the future, asset backed infrastructure deals that deliver regular income.

At a basic level resource efficiency is simply about using the planet's finite resources in a more sustainable manner, reducing the emissions of carbon dioxide and other greenhouse gases blamed for global warming.

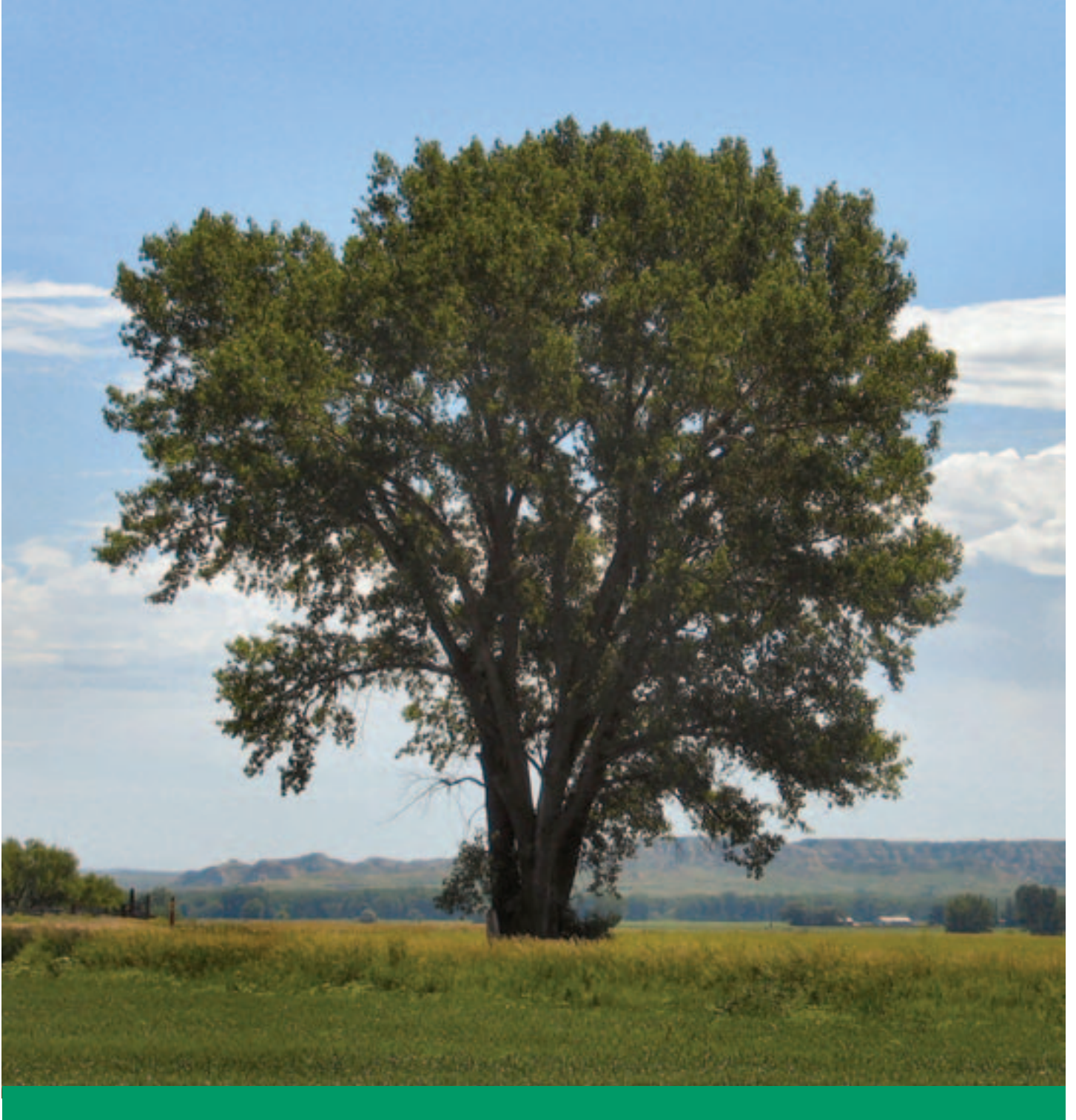
To promote sustainable investing, the Government has introduced literally hundreds of regulations, initiatives and targets stretching decades into the future. Individuals and companies could have access to tax breaks and government grants. Conversely, for those that do not comply, there is the threat of taxes and penalties. Both these approaches should stimulate growth in the sector and make the conditions for investing very attractive. Under the Kyoto Protocol, the UK is committed to achieving a 12.5% cut in greenhouse gas emissions by 2012, with the ultimate goal, as stated in the Queen's Speech 2006, of making the 60% reduction by 2050 statutory.

In terms of renewable energy, the Government's Renewables Obligation requires electricity suppliers to derive 15.4% of electricity from renewable sources by 2016. A similar obligation for transport fuels will require that biofuels or other renewable sources account for 5% of fuel sales by 2010, while the Climate Change Levy taxes companies on their use of carbon fuels, pushing them to invest in environmental technologies.

It is not just about cutting the use of carbon fuels; there is concerted action to encourage the development of alternative technologies. In September 2006, plans were announced for a £500 million National Institute for Energy Technologies to lead research into low carbon energy technologies. This was followed by the launch of a £50 million grant programme for hydrogen, fuel cell and carbon abatement technologies. Tax breaks for biofuel production plants are also on the horizon, as is an overhaul of the planning regime for renewable energy production.

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Add in oil price uncertainty and security of energy supply, not to mention the simple fact that supplies of fossil fuels are running out, and it is clear that the growth of the sustainable investment sector is built on solid, long-term foundations. As Sir Nicholas Stern explained in his recent Treasury-commissioned report on climate change, global warming could shrink the global economy by 20%; a conclusion which spurred Tony Blair to affirm that: “we can't wait the five years it took to negotiate Kyoto; we simply don't have the time. We accept we have to go further [than Kyoto].”



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