SUSTAINABLE TECHNOLOGY INVESTORS LTD

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SUSTAINABLE RETURNS

Amid the press debate surrounding the recent budget, most media commentators missed the Chancellor's push for investment in Britain's "world-leading energy sector, including renewables". But a growing number of investors are recognising the opportunities available.

The case for investing in sustainable infrastructure and technologies, such as renewable energy and energy efficiency, is becoming increasingly compelling.

With the assistance of skilled fund management, the returns available are highly attractive. Changes to the Enterprise Investment Scheme, confirmed in the budget, enhance the appeal.

Strong Investment Market Opportunity

The fundamental investment drivers for sustainable energy and resource businesses are strong as concerns grow about energy security and the long-term sustainability of oil supplies. Much of our energy comes from fossil fuels, which have an uncertain future. Nuclear power, for many years considered a viable alternative, is no longer a straightforward or politically palatable choice, particularly in the wake of last year's sad events in Japan.

The sustainable investment opportunity is therefore growing and will be underpinned by a number of long term drivers.

- Energy and Resource Demand Growth: the world population is forecast to rise from 7 billion currently to over 9 billion by 2050. Many emerging economies are expected to grow their GDP per capita to levels comparable to current developed markets by 2050. World energy consumption is forecast to rise by over 50% from 2008 to 2035. The International Energy Agency (IEA) estimates that cumulative energy investment of $38 trillion will be required over the period to 2035 to meet growing energy demand.

- Energy and Resource Supply Constraints: these include 'peak oil', water security, resource security and commodity price rises and volatility. Many fossil fuels are being gradually depleted and remaining reserves are often in regions of political instability. Opinions vary as to when 'peak oil' – the point after which oil production starts to decline – will be reached, however the consensus is that the era of 'easy oil' is coming to an end.

  Commodity prices for resources continue to be volatile, driving a need for increased price stability through sustainable energy and resources, which are seen as a future hedge against price volatility. Water is becoming increasingly scarce and with more than 260 river basins crossing international boundaries, there is intense global pressure to become more efficient with our use of water for domestic, agricultural and industrial production, and infrastructure and technology that can help do this is highly valued.

- Market needs for sustainable solutions: Falling costs for sustainable technologies, particularly with recent declines in solar photovoltaic (PV) costs, are making such technologies increasingly cost-effective. There is also a strong international push to mitigate the effects of climate change and its financial consequences, such as insurance losses and wider economic decline. Many countries have identified the sustainable sector as part of their long-term growth strategy and see it as being able to generate significant job creation during a period of wider economic difficulties.

Strategies for investing

In order to generate strong returns to investors, a sound strategy is to focus on deploying capital quickly and efficiently in sectors such as energy generation (for example hydroelectricity, anaerobic digestion and biomass) or in efficiency (such as industrial processes, buildings, and water). This is assisted by targeting investments where revenues are either based on feed-in tariffs available in sectors such as anaerobic digestion, hydroelectricity and community projects, or where investments will benefit from revenues from counterparties such as local authorities or utilities.

We feel there is a strong risk return trade-off through investing into developing cash generative businesses, preferably with revenue streams from strong counterparties and covenants. If available, Government feed-in tariffs for green energy generation also complement this investment strategy. A further benefit of such an approach is that it offers downside risk mitigation because of the significant component of yielding assets.

In February, our own strategy of investing in sustainable development businesses was rewarded when our anaerobic digestion investment Adgen Energy was acquired by Tamar Energy, which announced plans to establish a network of more than 40 anaerobic digestion plants in the UK. We re-invested in Tamar, which is also backed with £65m of funding from a group of high-profile investors, including Rothschild Investment Trust, Lord Rothschild, the Duchy of Cornwall, Middle Eastern sovereign wealth funds and Sainsbury's. It has also won public support from the UK government for its plans to generate 100 megawatts of green electricity within five years.

It is important to remember however, that this is a highly specialist sector in which access to a deal pipeline is extremely important. Investors and advisers should seek out investment managers with access to so-called 'spade-ready' projects.

Attractive EIS Investment structure

As structures for gaining access to opportunities in this sector, Enterprise Investment Schemes (EIS) have particular attractions for UK taxpayers, principally because of their suite of valuable tax reliefs. The initial 30% income tax relief that EIS investors receive can offer a significant uplift to their final returns. When this is combined with an investment strategy in sustainable businesses, a strong investment return over five years can be achieved.

A further benefit of investing in a structured EIS scheme is the access it can give to highly qualified, expert and talented management teams with strong track records. They can also provide diversified portfolios of investments that will not be strongly correlated to stock market movements because of the secure and high quality revenue streams discussed above.

Sustainable energy and efficiency businesses and assets offer strong investment returns, especially when combined with EIS tax reliefs that allow these gains to be received by investors unencumbered with a tax burden. Demand growth, energy security and supply constraints all offer long term investment markets. Coupled with government commitments to reduce carbon emissions and substantially increase renewable energy generation in the short to medium term, the sustainable investment market offers strong returns to investors. As a further benefit, they will also be backing businesses that can have a positive impact on our environment.

The key tax benefits of EIS to UK taxpayers are:

- Income tax relief at 30%
- Tax free capital gains when the shares are sold
- Capital gains tax deferral
- Inheritance tax relief after two years
- Loss relief at investors' marginal rate of tax

Jim Totty has 19 years' experience in sustainable technologies and 11 years experience in private equity fund management.

About Sustainable Technology Investors Ltd (STIL)

Sustainable Technology Investors Ltd (STIL) is a fund management business founded by Gordon Power and Stephen Lansdown in 2009 to provide capital for and mentoring to fund managers and businesses located in Europe, Asia, the Americas and Africa whose primary focus is renewable energy and sustainable technology.

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