WEEKLY ANALYSIS

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ALTERNATIVE ENERGIES: A KEY THEME FOR 2024

Temporary halt to energy transition. Drastic profit revisions. Excessive price corrections. Impact of rising interest rates already factored in. Medium-term outlook underestimated. Attractive valuations for 2024.

Key points

- The energy transition is temporarily threatened by inflation, rising interest rates and some changes in political direction
- Historic but volatile investment opportunities
- Alternative energies more sensitive to rates than the oil sector
- Main reasons for the sudden price collapse
- A key investment theme
- Particularly attractive valuations

The energy transition is temporarily threatened by inflation, rising interest rates and some changes in political direction

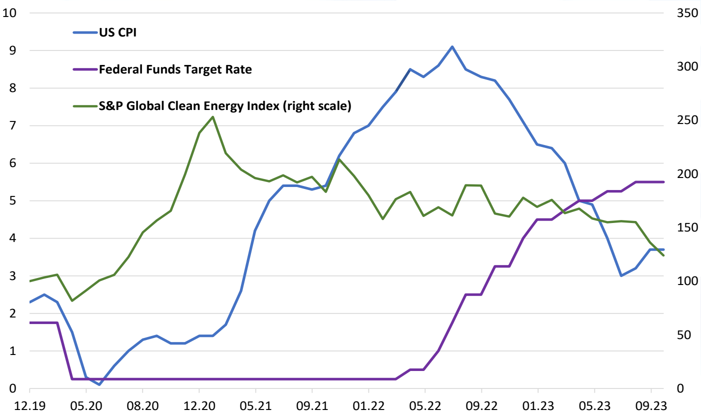
As extreme weather events with catastrophic effects of various kinds become more and more prevalent across the globe, global warming is also becoming increasingly evident to people and governments alike. Increasing climate upheavals, extreme droughts and devastating floods are further underpinning the determination of governments and the global CO2 emission reduction targets adopted by most governments in the developed world. The targets set in Europe and the USA in particular have not been fundamentally called into question in recent months, but their implementation seems to be suffering from the damaging trend in inflation and the highly penalizing rise in interest rates and financing costs.

The energy transition to clean, renewable energies is therefore still firmly underway, with no major risk of being called into question, but it is temporarily threatened by financial and economic parameters that have been evolving negatively for several quarters and deteriorated further over the summer.

In the USA, President Biden's Inflation Reduction Act and the Green New Deal support alternative energy development plans by providing subsidies to companies developing green energy. In the UK, the government also wants to achieve net-zero consumption by 2050, while in Europe the Green Deal Industrial Plan will also support funding for transition projects. These regulations will have a lasting effect on value chains, which will also be strongly impacted by the competition induced by the various support measures adopted by governments. These measures will support the emergence of new technologies and the targeted development of alternatives of various kinds. But they may also lead to the relocation of activities, as well as the introduction of tariff barriers to protect exports from China to Europe and the United States, for example. The energy transition is unlikely to be linear and smooth. It is therefore likely that certain obstacles or changes in direction and strategy will temporarily disrupt a trend that nevertheless seems clearly unstoppable. In fact, we're already seeing a few reactions here and there from political decision-makers, who are sometimes backtracking on certain objectives or on the means to achieve them.

While these actions are indeed likely to give rise to new uncertainties, it seems clear that they will not call into question the need to implement this transition. The automotive sector, in particular, is concerned by some of these recent actions aimed at rethinking the objectives of banning all-petrol and diesel vehicles within a timeframe of less than 10 years, deemed too short and too costly.

US CPI, Fed Funds, S&P Clean Energy Index



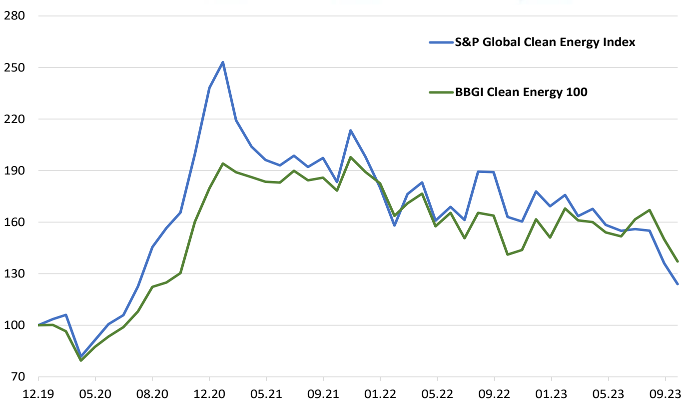
Sources: Bloomberg, BBGI Group SA

Historic but volatile investment opportunities

In 2023, more than ever, the energy transition remains one of the greatest structural challenges facing the global economy, which must rapidly and comprehensively rethink its energy ecosystem, from production to consumption, including the storage and distribution of new forms of energy. The sums involved in implementing this transition are considerable, running into tens of trillions of dollars per decade if we are to achieve our climate objectives. Against this backdrop, it goes without saying that investment opportunities are colossal in many sectors linked to the implementation of this energy transition, and of course for all the current and future players who will be actively involved. On the stock market front, the global alternative energies sector - including listed companies active in the wind, solar, biofuels and energy efficiency segments - has experienced extreme volatility over the past three years. Years of strong rises have been followed by periods of sharp consolidation, creating performance volatility that is sometimes difficult to sustain for many medium-term-oriented investors.

In the last few years alone, this volatility has been expressed in extreme double-digit gains and consolidations. First, there was euphoria in S&P Global Clean Energy stocks, which had covered all segments by 2020. Government announcements of new energy policies favouring alternative energies had triggered capital flows and price rises of over +300% between April 2020 and January 2021. The downturn in 2021 (-40%) was followed by a period of stabilization in 2022, during which alternative energy stocks still outperformed the global indices, which were down sharply at the time (MSCI World index -17%). This was followed by relative stability in the first half of 2023, before the summer's acceleration in interest rates upset the balance, causing prices to plunge by almost -30% in three months. The S&P500 Global Clean Energy Index, the leading index of energy transition stocks, is now down -60% since its peak top reached on January 8, 2021. Between December 31, 2019, before the outbreak of the pandemic, and today, the S&P Global Clean Energy Index (+44.5%) and our BBGI Clean Energy 100 Index (+50%) have nevertheless gained +10.5% and +11.6% respectively per year.

S&P500 Global Clean Energy & BBGI Clean Energy 100 (31/12/2019– 2023)



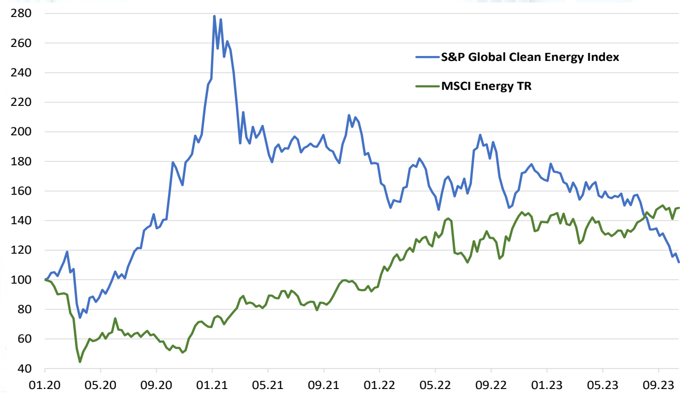
Sources: Bloomberg, BBGI Group SA

Alternative energies more sensitive to rates than the oil sector

Despite tens of billions of dollars in tax credits, subsidies and various support measures, the alternative energies sector is clearly losing ground after the 120 basis point rise in US long-term rates which pushed ten-year Treasury yields from 3.8% to 5% between June and October (+30%). Companies active in the wind and solar power sectors suffered more from the rise in interest rates than traditional oil stocks, which benefited from persistently high oil prices. The rise in oil prices (+27%) pushed traditional oil stocks in the energy sector, less affected by interest rates, a little higher. The S&P Global Clean Energy index, which comprises 100 of the largest companies in the solar, wind and other renewable energy sectors, has thus fallen by -26% since the end of May, while the S&P500 Energy index has risen by +19% in the wake of higher WTI crude oil prices. A continuation above $75 a barrel has enabled oil companies not only to generate substantial profits and a healthy return on equity, but also to cope easily with rising financing costs.

In recent months, a mixed strategy comprising balanced exposure to traditional energy stocks and an allocation to energy transition stocks has enabled us to weather this period of inflation and higher interest rates with reduced volatility and an overall result close to zero (-3%) and similar to that of the MSCI World index in USD (+0.3%).

S&P500 Global Clean Energy & MSCI Energy TR (31/12/2019– 2023)



Sources: Bloomberg, BBGI Group SA

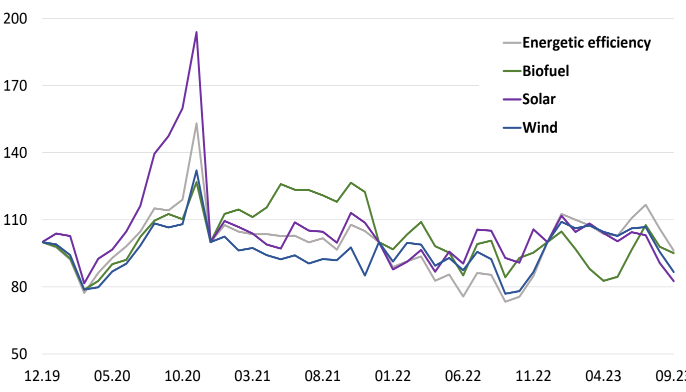
Main reasons for the sudden price collapse

The recent collapse in the share prices of many companies in the alternative energy sector can be largely explained by the sudden and rapid rise in interest rates observed in the space of a few months in 2023. Rising rates have a greater impact on companies whose earnings are expected in the distant future, which is the case for many companies in the sector. When rates rise, the discount rate for future earnings incorporated into valuation models also adjusts upwards, with the direct impact of reducing the present value of the companies concerned. On the other hand, certain alternative energy stocks such as utilities distributing green electricity, for example, are also often seen as investments offering attractive returns. As a result a rise in bond yields such as that seen in 2023 is bound to draw capital away from this sector to take advantage of higher yields and lower risk. What's more, the major investments required by some companies in the sector to develop their offering and expand their presence in this fast-growing ecosystem are being undermined by rising financing costs and increasingly difficult access to credit.

But on the demand side too, we are now seeing the short-term effects of rising interest rates. Demand from private individuals for photovoltaic systems is also subject to this hazard, which makes it more difficult in times of rising financing costs to proceed with investments that are sometimes already heavy, and whose overall cost is affected by increasingly unbearable financing rates. In this context, it's hardly surprising that certain investments are temporarily postponed or simply called into question. As a result, energy transition stocks are on course for their worst annual performance since 2013. As already mentioned, the renewable energies sector has been particularly vulnerable to rising interest rates. Not least because many companies enter into long-term contracts, fixing the price at which they will sell energy, before developing their projects. Rising costs linked to inflation, coupled with the opposite trend in financing costs, have clearly affected margins. The solar and wind power sectors were hardest hit by rising operating costs. Unfortunately, the negative impact of rising interest rates seems to have wiped out the positive expectations arising from the US Inflation Reduction Act signed in August last year, with most companies active in the energy transition now trading at lower prices than when the Act was passed. Russia's invasion of the Ukraine had initially supported a rise in energy prices (oil and gas), which also benefited the alternative energies sector.

Significant rises were recorded by solar stocks in 2022, when they naturally benefited from the craze for "green" energies, which also enabled them to free themselves from Europe's dependence on Russian gas. But rising interest rates and a number of political reversals affecting certain support programs also contributed to increasing investor uncertainty. A case in point is the change made by the State of California to reduce credits granted to owners of rooftop solar panels for the purchase of their surplus electricity. Such decisions affecting the largest solar market in the USA are not without consequences for the short-term results of companies such as Enphase Energy. In other areas, the implementation of offshore wind projects is also being delayed by rising costs, threatening the viability of industrial projects which could become unprofitable without a readjustment in the selling price of the electricity produced. U.S. wind projects would need to qualify for federal clean energy tax credits under the Inflation Reduction Act in order to see the light of day and be profitable. If governments are serious about meeting their announced CO2 emission reduction targets, they may need to provide additional fiscal support to companies in the sector. The latter, hard hit by inflation and rising interest rates, will need new support to resist the damaging effects of these factors. For some, an upward renegotiation of electricity sales prices to the public sector could prove indispensable.

BBGI Clean Energy 100
Solaire, Eolien, Biocarburant, Efficacité énergétique

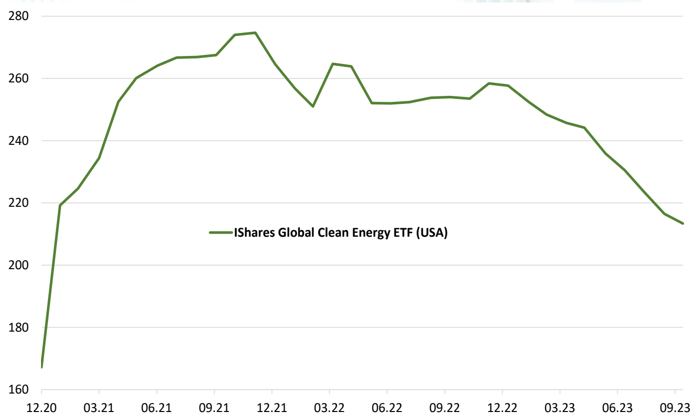


Sources: Bloomberg, BBGI Group SA

A key investment theme

Despite this totally new situation for alternative energy stocks, which is affecting their valuation levels, the investment theme remains largely a favourite of investors, who are reiterating their confidence in the sector's stocks as they embark on the inevitable restructuring of the global value chain for the production, exploitation, storage and distribution of energy alternatives to fossil fuels. Fund flows into Clean Energy ETFs have in fact increased further since the end-2020 top, as shown by the evolution of shares in the iShares Global Clean energy ETF USA by Blackrock Fund Advisors, which rose by +27%, while the NAV fell by -60%. Over the same period, net assets fell by just -33%, thanks to these inflows of new funds. This trend was even stronger in Europe, which benefited from reinvestments of up to +40%. This continued inflow of capital during a period of low yields and structural upheaval testifies to the strength of investors' conviction and confidence in the underlying theme. The need for alternative energy solutions remains compelling, and current valuations may provide an attractive entry point for those with a longer investment horizon.

Flux de fonds dans l'ETF IShares Global Clean Energy

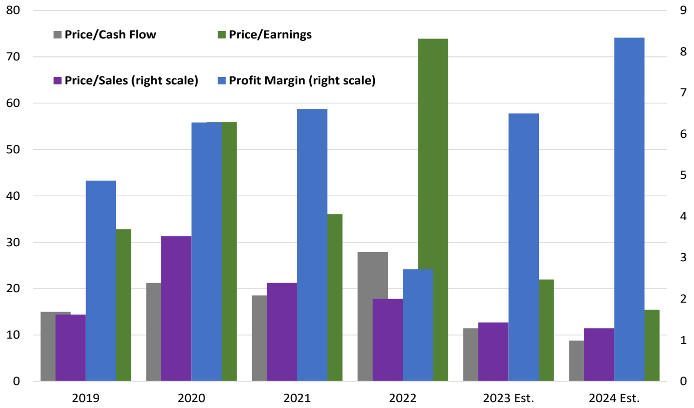


Sources: Bloomberg, BBGI Group SA

Particularly attractive valuations

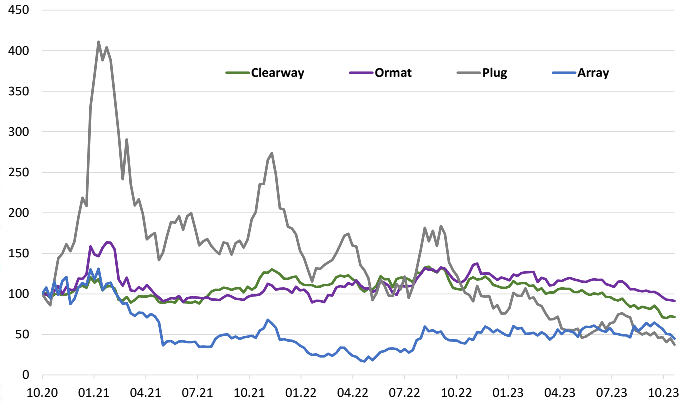
This unexpected correction in the share prices of players in the energy transition can be seen as relatively healthy in that it has already sharply adjusted prices to the current realities of rising financing costs, while perhaps now underestimating the long-term prospects of these same companies. In terms of the valuation of listed companies, we now believe that the extreme pessimism that has driven down the prices of solar, wind and hydrogen stocks has led to a sometimes massive underestimation of the long-term profit outlook for these companies, which will most certainly be the main winners in the ongoing and irreversible process of energy transition. The overall valuation level of the S&P Global Clean Energy index has fallen to 15x expected earnings for 2024, even though major sales and revenue revisions have already been announced. By way of comparison, the index's P/E was 81x in 2020 and 95x in 2022. The price/cash flow ratio has fallen from 27x (2022) to 8x for next year. Similarly, the price/sales ratio has also adjusted downwards, from 4.5x in 2020 to just 1.33x for 2024. While gross margins remained close to 30% until 2022, average profit margins for all the stocks in the index will again be at their highest in 2024. After slipping from 6.28% (2020) to just 2.7% in 2022, profit margins for 2023 (6.95%) and 2024 (8.4%) are back to attractive levels. In terms of average indebtedness, the ratio of total debt to total assets is set to rise, although it has remained relatively constant in recent years between 35% to 43%.

Données fondamentales S&P Global clean Energy Index (PE, PCF, PS, MB)



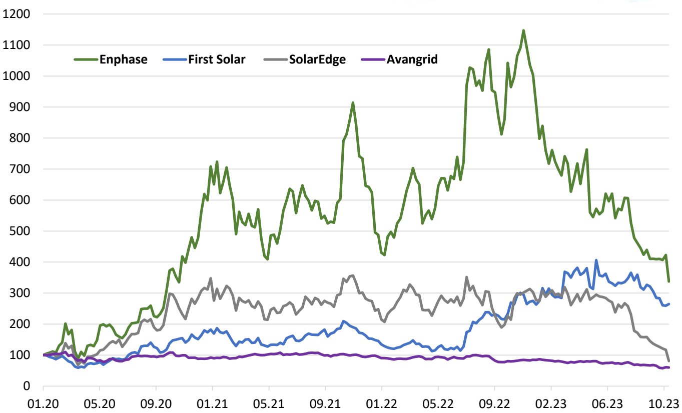
Sources: Bloomberg, BBGI Group SA

Clearway, Ormat, Plug, Array



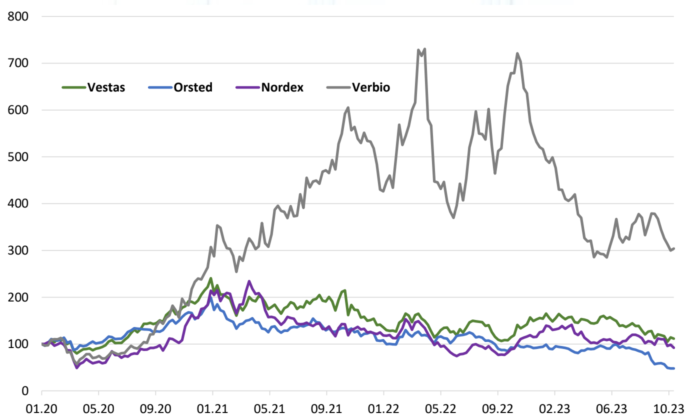
Sources: Bloomberg, BBGI Group SA

Enphase, First Solar, SolarEdge, Avangrid



Sources: Bloomberg, BBGI Group SA

Vestas, Orsted, Nordex, Verbio



Sources: Bloomberg, BBGI Group SA

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