Alternating currents

environmental impact on electricity utility landscape

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Traditionally seen as a stable - even unexciting - part of the economy, utilities and particularly energy utilities are now undergoing rapid and dramatic change. Driven by the need for secure, affordable and low-carbon energy, energy utilities are investing in new generation technologies including offshore wind, nuclear, biomass and carbon capture and storage.

In this latest interview, George Latham, Head of SRI Funds at Henderson provides his perspective on the UK utilities sector.

George, Head of the SRI team at Henderson, could you explain your capabilities here and go through your process?

Henderson has been involved in the Sustainable and Responsible Investment (SRI) industry, for over 30 years now. We started running funds in the mid 70s. We currently have a team of seven with £726.4m in SRI assets under management (at 31 December 2009).

The team is divided into investment professionals and sustainability analysts. We have a team of sustainability analysts, headed by Seb Beloe, that do the analysis on the mega trends, in terms of sustainability problems and solutions to those problems and also in terms of company level analysis around corporate responsibility.

On the investment side, we have two suites of funds. One is a global set of funds which are run on a thematic basis, headed up by Tim Dieppe. I run the Henderson Global Care UK Income Fund and the Henderson Global Care Managed Fund.

Energy is a major theme in climate change. What do you believe to be the medium term trends in the energy utility sector?

I think it is a very interesting area which is going to see long-term change. The companies which react early to it are likely to be winners in the longer term. So you have an industry, particularly in the energy utilities industry, where really it has been about selling more electrons than the next man, or more electrons year-on-year to your customers.

What is going to change, is that the supply companies are going to move from just being effectively billing engines to being energy services companies. There is also going to be a trend towards less centralisation in terms of energy generation, so more smaller scale generation in communities and even in the home. Services companies will be able to provide perhaps greater added value in the longer term as they look to provide you with heat and power to your home, rather than just more electrons than they did the last year.

On the decarbonisation of electricity generation, do you think the targets of 2020 realistically can be achieved?

They are quite substantial targets, considering where we are today and where we have come from. We are looking to provide 35% of energy or electricity generation from zero or low carbon sources by 2020. That is quite a stretch given where we are today. So there are a number of different ways, different abilities of different companies to react to this, and those companies that have started early are going to be in a better position for the longer term.

Companies like Scottish and Southern Energy, which have made early investments in wind power generation to build up their portfolio of low carbon generation, are going to be in a strong position. Companies with a heritage of high carbon intensive investment, like Drax with its coal fired generation, are going to face a struggle over the next 10 years or so. Regulations and penalty fees are going to become ever more stringent as the UK strives to reach those targets.

How is this going to impact energy pricing going forward?

It is likely to go up. I think in the medium to longer term, we are going to see higher energy pricing, higher costs of energy. It will come from both an increasing scarcity of fossil fuels and by the relatively higher costs of a number of younger renewable technologies.

Could you go through some of the merits of these different low carbon energies?

Really in terms of what the customer sees, although the price of energy on a per watt or a joule basis is likely to go up; it may not actually feed through necessarily on a straightforward basis to the customer. This is because the best form of low carbon technology is to reduce the amount of energy that we consume in the first place. So energy efficiency measures are one of the areas that we have focused on, particularly in terms of reducing the amount of demand and therefore reducing exposure to these rising prices and the necessity for change.

So areas like insulation, investment in the transport and distribution infrastructure to make it more efficient, and around making buildings more energy efficient are generally the fastest payback and lowest cost ways to invest and to reduce the carbon footprint of the energy mix.

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You touched on regulation a little earlier; does this have much of an impact on the sector?

The utility sector is clearly a heavily regulated sector. This is an area where we expect to see the increasing impact of regulation. This can be a positive and a negative thing from an investor perspective.

So regulation often reduces risk in the investment profile for a company. The fact these utilities are going to have to invest very heavily means the regulator does need to provide companies with an incentive to make that investment. So they need to make investment attractive for those regulated utilities.

On a broader note now, do you think investors and the public have fully embraced the climate change theme?

I think there has been a building momentum in that direction. But I do not think we have really got there yet. The fundamental issue around climate change and investment is around timeframes. Climate change is a very long-term process and the changes it is creating are happening on a long-term basis. So you have to be a long-term investor to take account of these issues and to invest using these insights as a basis for decision making. The market is very much divided between those who take a longer term view and those who operate on a more short-term basis. So it tends to be those longer term investors who have embraced climate change as an investment theme.

On Copenhagen, are summits and global initiatives the way forward or should a lot of these issues be resolved at a national level?

In the longer term we need global initiatives to create a framework. The whole issue around climate change, around carbon, is a common good and that is something that is shared on a global basis and therefore the actions taken in one part of the world have a significant impact on us, and on other parts of the world as well. So we need a global framework but that is clearly going to be very difficult to achieve and so we need a national momentum at the same time.

What would be your key message then for investors in 2010 and beyond?

There are two key messages. Firstly, that the standards required of how companies operate in the market with respect to all of their stakeholders are going to continuously rise. This is going to require companies to implement, in an increasingly strategic way, better standards of corporate responsibility. Identifying those companies which have strong approaches will help us to identify the winning companies.

Secondly, the momentum behind sustainability themes, or the momentum behind a wish to find solutions to sustainability challenges is increasingly robust. This is not just with an environment agenda; it is also with a social agenda as well. These challenges are increasingly acute around healthcare, around education, around an ageing population, around environmental problems. Companies which can provide a solution to some of those challenges are going to face a growing end-market and that is going to lead to profitable growth in the longer term.

These are both important investment strategies from an investment returns perspective, and neatly combine with pursuing a more robust and more sustainable future for us all in the longer term.

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