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Towards Greener Pastures

As the country gears up to reduce its carbon emissions, investors need to churn their portfolio to accommodate companies that are greener than the rest.

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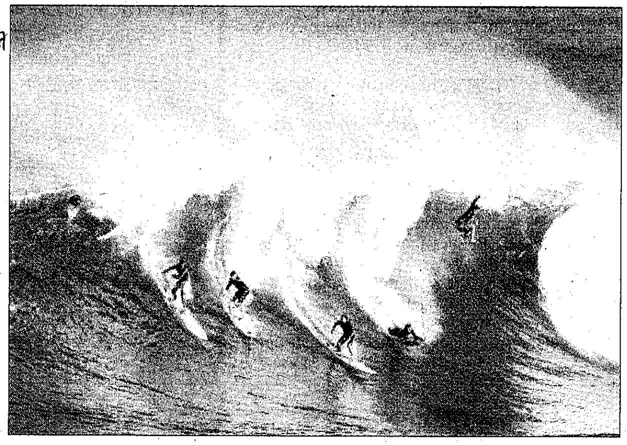
Now that the equity markets have firmly set aside the ghosts of 2008 and as global economy hits the growth track, it's time to acknowledge long-term concerns. And globally the biggest topic of discussion right now is the climate change and its impact on the business and economy. Till few months ago, it seemed that, developing countries including India would be spared the economic and financial pain of participating in the global effort to cut carbon emissions. With each passing day however it seems that large and fast growing developing countries especially India and China will have to do their bit to arrest climate change. In run-up to the global Copenhagen Conference in December this year, India has already established a climate change mitigation authority that will set targets to reduce emissions by 2020. There is also a proposal to establish a ministry dedicated to promotion of alternative energy.

Though the details of the emissions reduction programme are sketchy right now, the ball has been set rolling. It will gather momentum as the time passes and as the global debate on the subject heats-up. This in turn will set a chain reaction of new set of economic policies, which will have profound impact on business and the equity markets. Indian investors and business have grown-up with the idea that environment and natural resources are free public goods, which should be exploited to the hilt to maximise their profits. This mindset will not work in the new paradigm that is emerging.

India's economic and industrial policy will be tweaked in future to minimise the carbon footprint of every unit of economic output or GDP. This means that Indian companies especially those responsible for bulk of the emissions will have to progressively reduce their carbon intensity to the targeted level. This will require investment in new technologies, re-engineering of production process or changing their product mix altogether. Obviously it will raise their production cost, at least in the short-run besides slowing their pace of growth. The emissions reduction programme will also have a set of incentives for industries and technologies that will help companies and consumers to cut down their carbon intensity. This will pit many existing behemoths with new entrants and may create new winners and losers in the longer term.



The companies most at risk in the new regime would be those who generate coal-fired thermal power. Globally, such power plants are one of the biggest contributors of greenhouse gases and stand second only to transportation sector in pollution league table. Currently, power is the most happening sector on the stock exchanges and most power sector companies are enjoying rich valuations. The new regime may however make operations expensive for coal fired power plants and make them less attractive compared to rival sources of power such as hydel, wind, gas or biomass.

Among individual stocks, NTPC owns the largest number of coal-fired thermal power plants in India accounting for nearly 30% of the power generation in the country. Next comes, Tata Power, Torrent Power, Reliance Infrastructure and CESC among others. While there is no immediate threat to the economic viability of any of these power utilities, investors would be better of by rebalancing their power portfolio in favour of companies that are greener than others. For instance, among leading utilities, Tata Power has one of largest portfolio of projects based on renewable energy including hydel, wind and solar power. It continues to make several other experiments in renewal energy space. This puts the company at a stronger footing than the rest.

On the equipment side investors are advised to de-risk their investment by diversifying into companies that are supplying the equipments to renewable energy sector. This includes companies such as Suzlon Energy, which makes wind turbines, Moser Baer, which is investing heavily into solar photovoltaic technology and Thermax that supply pollution control equipments and heat transfer equipments.

The most revolutionary change may however occur in the transmission and distribution segment of the power business. Right now, the entire power infrastructure is based on the concept of centralised (and large scale generation) and distributed consumption. Power is generated in huge generating station located near the source of energy i.e. coal mines in central and eastern India or river valleys in Himalayas and transmitted to the consuming centres hundred of kilometres away through high tension transmission lines. This however leads to huge transmission and distribution losses, which could be as high as 30% of energy generated. Besides, its requires use of metals and cement -two of the most energy intensive materials -to build the transmission infrastructure

The new regime will give fillip to the concept of distributed generation near the site of consumption. In practical terms it means small and compact power stations supplying a neighbourhood or an industrial estate. These small plants are also likely to harness locally available resources such as biomass, wind, small stream or waste heat to generate electricity. This is already happening with the establishment of 10-120 MW size plant based on biomass or waste heat recovery. The movement is expected to gather pace as the concept gets established and the supporting ecosystem evolves. This may make dinosaurs out of existing power sector behemoths.

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