

HAS THE CLEAN ENERGY THEME RUN OUT OF STEAM!

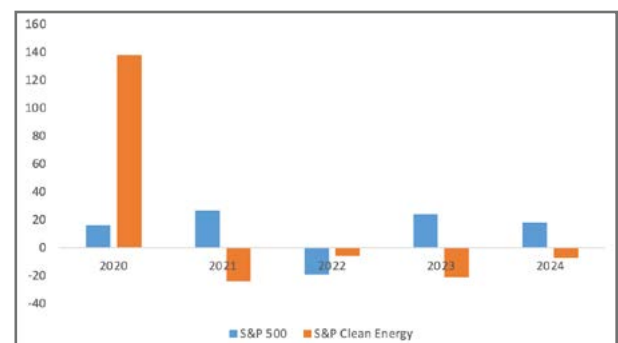
- Clean/Green energy refer to energy generated from sustainable sources like solar, hydro and wind.
- S&P Global clean energy index more than doubled in 2020 during the first wave of covid pandemic, but is currently down 56% from its peak in Jan 2021 (vs. 47% gain for S&P 500 over the same time frame). Year to date in 2024 the clean energy index is down 7%.
- The underperformance of clean energy stocks is attributable to various factors like surge in interest rates, high inflation and demand-supply mismatch.

What led to the reversal in fortunes?

- **Interest rate hikes increased the cost of capital:** Clean energy projects are capital intensive and have significant debt funding. Moreover, cash flows from these projects (many of which are covered within regulated utility framework) are long-term in nature. The process of negotiating contract prices with the regulator to offset the higher cost of capital takes time. Above factors make these projects highly sensitive to interest rate changes. The steep surge in interest rates since 2022 impacted the profitability of many clean energy companies resulting in a steep decline in share prices.
- **High inflation:** Competitive pricing is a large factor in making the renewable projects attractive vs. the conventional projects based on fossil fuels. Key commodities like polysilicon, steel, aluminium and freight costs form a significant portion (about 15%, as per International Energy Agency estimates) of the cost of total utility-scale solar PV and wind power projects. Increase in cost of these inputs over the past few years pushed up (supply chain issues being one primary reason) the development costs thereby impacting financial viability of projects.

Our View: Transition to green energy is essential considering the challenges posed by climate change. Europe has been global front-runner in green energy with electricity generated from wind power exceeding fossil fuel. Some players have been affected due to excess supply not meeting current demand. From an investment perspective while lower interest rates and declining inflation are a positive, it may not result in relative outperformance versus other sectors due to the high capital intensity of this industry.

Exhibit: Annual Performance (%)



Note: 2024 refers to the year to date performance as on 17.9.2024

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