GUEST COLUMN

"China's move towards a cleaner and greener energy mix and the government's attempts to significantly reduce its overall energy dependency have created several opportunities for investors," says Maoming Investment Manager's Julien Moulin

JULIEN MOULIN
CO-FOUNDER OF MAOMING INVESTMENT MANAGER

The latest economic data out of China shows that growth recovery continues to gain momentum and broaden from policy-driven to market-driven sectors. Indeed, the private sector is showing some signs of life with both capital spending and foreign direct investment (FDI) finally rebounding.

Maoming Fund still believes investors should not expect a sustainable overall market earnings recovery. Instead they should focus their portfolio on a couple of opportunities with higher visibility on earnings and a superior growth profile.

China's move towards a cleaner and greener energy mix and the government's attempts to significantly reduce its overall energy dependency have created several such opportunities for investors. Our team recently completed a lengthy review of more than 75 listed and unlisted companies in the alternative energy sector in China, with a large focus on the wind sector.

Wind power, currently the third largest power source in China after coal and hydro, will lead the alternative energy market in the next decade. No other green energy offers the same cost/benefit ratio. It has shorter plant set-up and lower production costs than other alternatives. And last year in China, more wind capacity was installed than any other technology, including coal and nuclear. This year, with 10GW new capacity installed, China is becoming the largest market globally and this growth is expected to continue. Indeed 12-13GW new capacity is to be installed in 2010 and discussions with both government bodies and industry experts indicate that the market will reach 150GW by 2020 since target figures keep rising.

Oversupply has already emerged in the wind turbine manufacturing marketplace with the removal of component bottlenecks. Nevertheless, the dominant players in terms of technology, quality control, productivity gains, relationships with large wind farm operators and government support, will consolidate the market, gain market shares, protect their margins and enjoy superior growth. Our market intelligence finds that larger listed companies such as Goldwind (002202:SZ) or Dongfang Electric (600875:SHA, 1072:HKG) and a couple of unlisted companies such as Sinovel or Envision Energy will perform exceptionally well.

Other opportunities recently appear in the value chain. Indeed, recent major government policies, such as grid connection priority and new favourable set prices for on-grid wind power combined with significant reduction in input costs, bodes extremely well for Chinese wind farm operators as well.

Our recent visit to 12 wind farm operators confirmed our view that Longyuan (China Longyuan Electric Power Group), the largest wind farm operator in China and fifth largest wind farm operator in the world, which is expected to list soon, should benefit dramatically from this new dynamic in the market.

The main bottleneck for a faster alternative energy development in China is the underdeveloped electricity network. So far, only 73% of cumulative installed capacity has been connected to grid. Indeed, most wind farms are located far from load centres, with poor grid infrastructure. And the intermittence and variability of wind power hugely increases the difficulty of grid management.

The owners of the grid have not been incentivised to ensure high connection rates, as wind power subsidies do not cover their additional operating expenditure and research and development costs to manage these upgraded grids.

So the government is now making sure that banks are lending in very favourable terms to State Grid and other private players looking to upgrade their grids to accommodate intermittent alternative power and/or expand the electricity grid to reach the distant wind and solar power facilities.

Grid operators will also be penalised by the government for failing to buy electricity from alternative energy players as recently seen in Jiangsu.

China has to solve this power transmission/distribution issue and we believe investors can take advantage of it by either investing in aluminium producers (or aluminium directly, for those who can play the commodity market) or alternative grid power equipment makers.

There are plenty of investors that are skeptical about global wind or other renewable energy investment opportunities. We believe the market dynamic in China is very different and that they are at the beginning of the alternative energy boom. There is still time to jump in.

Julien Moulin is co-founder of Maoming Investment Manager, an investment management company investing globally in listed and unlisted companies with a significant focus on Chinese companies.