19th November 2015

Taking stock a few weeks before 2015 draws to a close

Key Points:

- Solar energy, biofuels and energy efficiency have not managed to truly out-perform traditional equity markets in 2015
- Wind energy is the only exception (+22%), but businesses could face a decrease in demand outside of China in 2016
- Crude oil prices continue to have a direct and indirect impact on sub-sectors
- However, the negative impact of the Chinese equities market slump on the solar energy segment is fading; new opportunities are taking shape in this sector

Mixed results since January

2015 will undoubtedly draw to a close with disappointing results for the various segments of the alternative energy sector.

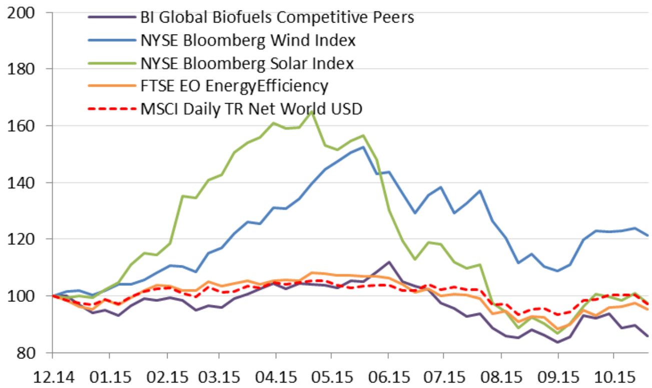
Indeed, since 31st December 2014, only the wind energy segment has truly managed to out-perform the MSCI World Index (+22.87% for the NYSE Bloomberg Global Wind Index, compared to +0.69%).

The solar energy sector also enjoyed a promising start to the year, but then suffered to a greater degree following on from the correction to the Chinese equity market this summer (see our analysis dated 17th July 2015). It has therefore posted a slight -2.59% correction since January (NYSE Bloomberg Global Solar Index).

As we already highlighted, the energy efficiency segment displayed similar stock market performance to general indices. It has recorded -1.60% since the start of the year.

Finally, companies operating in the biofuels field have posted -14.72% since January, having been affected by the drop in crude oil prices to a greater extent.

Sub-Sector Evolution (31/12/2014-19/11/2015)



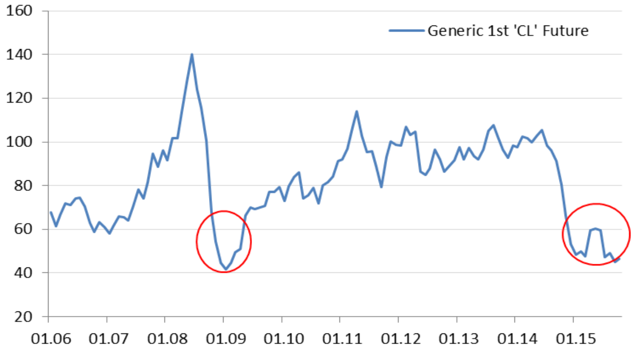
Sources: Bloomberg, BBGI Group SA

Impact of the drop in crude oil prices: putting it into perspective

In our previous analyses, we spoke of the negative impact of falling crude oil prices on the different alternative energy segments.

Crude oil prices have plunged -61.53% since the end of June 2014. Not having really picked up since then, oil prices have undoubtedly considerably changed investors' perceptions. Today, the barrel is trading at its lowest price since January 2009, at just a little above US $40.

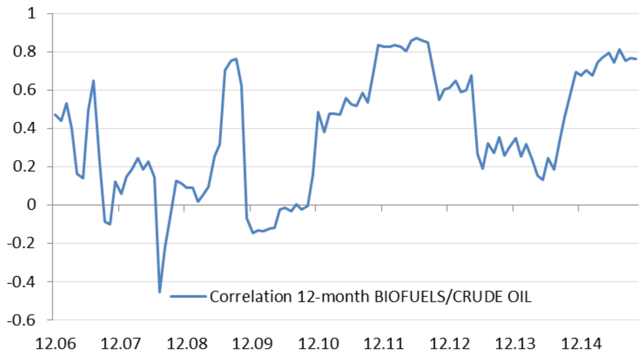
Crude Oil Price Evolution (31/12/2005-19/11/2015)



Sources: Bloomberg, BBGI Group SA

The correlation between crude oil prices and the performance of companies operating in the biofuels field is rather self-evident, as in the long-run biofuels could replace fossil fuels. However, although the twelve-month moving correlation between the sector's company index and crude oil prices has significantly strengthened over the last few months, currently standing at close to 0.8, this has not always been the case. Indeed, historically, this correlation has always been more pronounced in periods of considerable fluctuation of crude oil prices, as is currently the case.

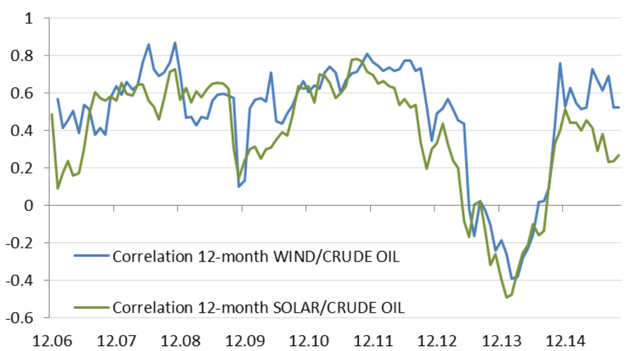
Biofuel Sector – Crude Oil Correlation



Sources: Bloomberg, BBGI Group SA

For wind and solar energy sector equities, however, the correlation is less striking. Nevertheless, since 2014, the increasing correlation between crude oil prices and the prices of solar and wind energy companies has not been anodyne.

Solar and Wind Energy Sector – Crude Oil Correlation



Sources: Bloomberg, BBGI Group SA

By way of comparison, the traditional equities market indices show high correlation with crude oil prices in periods of great panic. This is what is known as the "correlations go to one" phenomenon (for example, at the end of 2008, the MSCI World Index was posting a correlation of nearly 0.8 with crude oil prices).

The renewed strong correlation between crude oil prices and the prices of companies operating in the alternative energy sector in 2015 can in part be explained by the fact that there are many ETFs (Exchange-Traded Fund) in the energy segment, with some including companies in the solar energy sector, and sometimes also the wind energy sector. With crude oil prices falling, many investors have sold these ETFs, which has had an indirect impact on the prices of these two segments.

We believe that another factor that could explain this phenomenon is the fact that investors mistakenly believe that technologies linked to solar energy and wind energy are substitutable for oil products.

Wind and solar resources are not finite. Technology in this field allows us to produce electricity directly, whereas less than 5% of the world's electricity is produced from oil. As such, the two markets are almost entirely unrelated, as we highlighted in our January analysis.

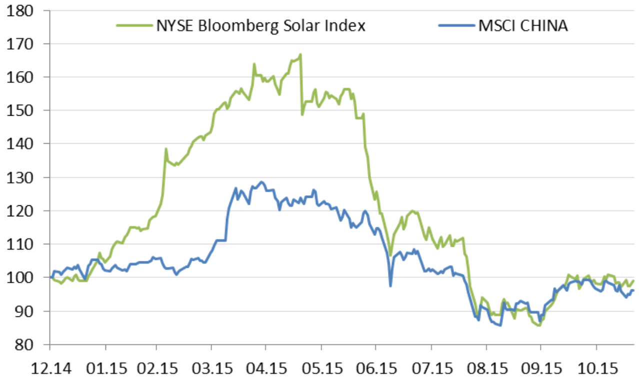
Solar energy: the negative impact of the Chinese market slump

The drop in Chinese equities was the factor that most affected the solar energy sector over the summer. Nearly 50% of the NYSE Bloomberg Solar Index is made up of Chinese companies. As of May, concerns regarding the pace of Chinese growth started to affect the Chinese stock market, which shrunk significantly between the end of May and the end of September (-26.88% MSCI China Index). The 27th July saw the greatest daily correction since 2007. The A-Shares CSI 300 Index slid -8.5%, whilst Chinese equities listed in Hong Kong (H-shares) lost -4% between opening and closing. In August, the Chinese government sparked fresh panic on financial markets, by announcing that the fluctuation limits for the yuan would be increased (previously set at ±2% per day).

Indeed, although investors had long been calling for devaluation of the yuan, the government's actions were interpreted as an admission of the "gravity" of the Chinese slowdown.

In parallel, the NYSE Bloomberg Solar Index plunged -42.21%, after having leapt +58.81% over the first four months of 2015.

Price Evolution – Solar and Chinese Equities



Sources: Bloomberg, BBGI Group SA

Today, the Chinese market has stabilised and Chinese companies will be able to take advantage of their currency's newfound competitiveness for exports.

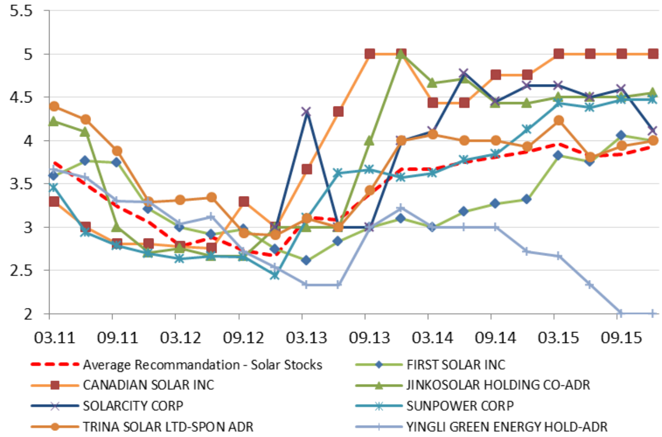
What holds true for Chinese companies in general also holds true for Chinese companies operating on the solar energy market. Exports to Europe and the United States are of course still stymied by the anti-dumping duty imposed by these two regions. Nevertheless, emerging countries, particularly in Latin America, are currently the most dynamic markets for new solar panel installations. Proof of this came, for example, in the form of Brazil's statement in September, that their authorities would double their goal for solar energy installations by 2024 (to 7GW). The Chilean government announced an ambitious goal of meeting 70% of their energy needs with renewable resources by 2050, whilst in September the Argentinian government revised its goal to 20% renewable energy by 2025, in addition to new support mechanisms. It is therefore well worth betting that Chinese companies will see an increase in their activity in these regions thanks to their already attractive prices and the newfound competitiveness of their currency.

International trade should also benefit from the upcoming change in status of the Chinese currency. It now looks set to become a true benchmark currency, as the IMF deems that it has "met all of the criteria" required to join the Special Drawing Rights (see our Weekly Analysis dated 17/11/2015).

As regards the solar energy market globally, analysts generally remain confident in terms of the price progression of the sector's big actors over the next twelve months, as demonstrated by the graph top right. On average, analysts' recommendations have increased from 2.7 (December 2012) to 4 (forecasts for December 2015)[1]. The companies CANADIAN SOLAR, JINKOSOLAR and SOLARCITY saw the most striking developments.

[1] Reminder: 1= Strong Sell, 2= Sell, 3= Hold, 4= Buy, 5= Strong Buy.

Analysts' Recommendations – Solar Sector



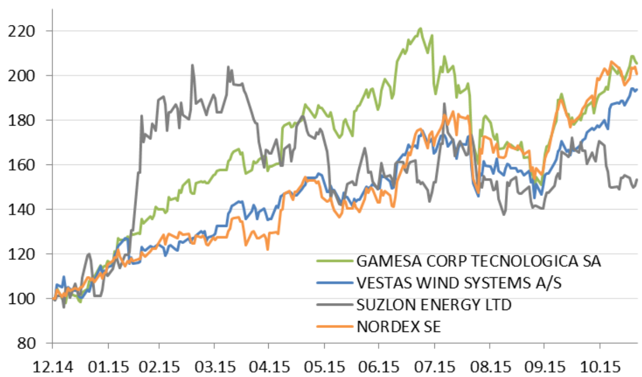
Sources: Bloomberg, BBGI Group SA

Wind energy: sector benefiting from an explosion in demand

In our introduction, we underlined that even though it corrected significantly between May and September, the wind energy sector has nonetheless grown +22% since the start of the year.

This considerable increase can be explained by impressive performances posted by iconic actors in the sector. The prices of GAMESA CORP, VESTAS WIND SYSTEMS, NORDEX and SUZLON have leapt +105.44%, +93.12%, +103.83% and +58.39% respectively since the start of 2015.

Price Evolution – Wind Energy Market Actors

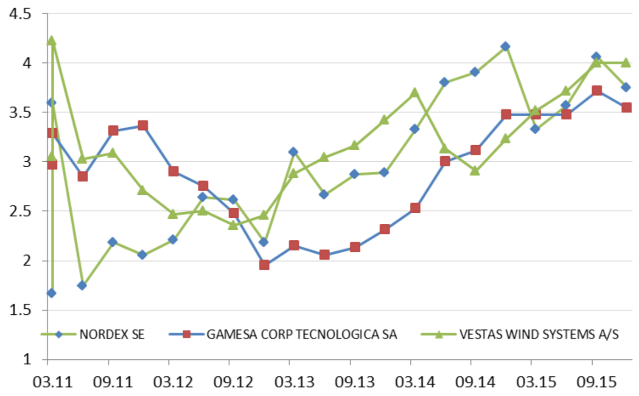


Sources: Bloomberg, BBGI Group SA

The wind energy sector has remained extremely attractive due to the strength of demand and the improvement to companies' margins. These had remained lacklustre for a long time despite the sector picking up. Companies in the wind energy sector have benefited from a significant improvement to their order books; according to Bloomberg, publicly announced orders increased by +35% over the first nine months of the year. Thanks to this, their balance books have improved- operating margins grew from 5.5% to 5.9% from the third quarter 2014 to the third quarter 2015, based on the median.

For companies NORDEX, GAMESA and VESTAS WIND, which analysts follow closely (unlike SUZLON), analysts remain confident overall, as shown by the graph below. Consensus sits at between 3.5 and 4 for these three companies.

Analysts' Recommendations – Wind Energy Sector



Sources: Bloomberg, BBGI Group SA

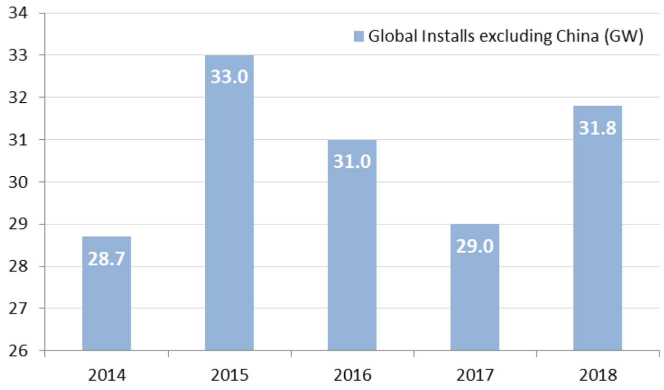
Companies in the sector have therefore benefited from a record increase in installations in 2015. 2016, however, could prove more difficult.

The lack of political vision is of great concern. In the United States, it has yet to be confirmed whether tax credits will be extended into next year, although this could still take place at the end of the year. In China, the government may seek to gradually reduce the feed in tariff for electricity produced via wind energy between now and 2020; its aims in terms of new installations (to be set out in its new five year plan) are yet to be confirmed.

In Europe, governments are reducing subsidies, and some are now preparing to put in place a capacity auction system for the electricity market.

According to a study by the German wind turbine manufacturer NORDEX, installations outside of China could drop from 33 GW to 31 GW in 2016, and then 29 GW in 2017, before starting to increase again in 2018.

New Wind Energy Capacity (Nordex)



Sources: Bloomberg, BBGI Group SA

Conclusion

2015 has been rather disappointing for equities markets in general, and the same can probably be said for alternative energy.

Wind energy is bucking the trend (+22%), but forecasters now seem to have less confidence in the segment after a record 2015.

Even though it has been delayed by the quantities of oil that had been stockpiled, the recovery of crude oil prices, based on global consumption, should lead to renewed interest in the alternative energy sector on the part of investors.

Thanks to their dynamic image, companies in the solar energy sector in particular should benefit from the renewed confidence in equities markets and once again record significant out-performances.

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