

Green boom's hottest trade in 2021 may turn out to be utilities

After a bumper year for Europe's renewable-energy stocks, underappreciated utilities shares are now gaining support from the market as 2021's hot sector to play the clean power transition.



| Photo: Vattenfall

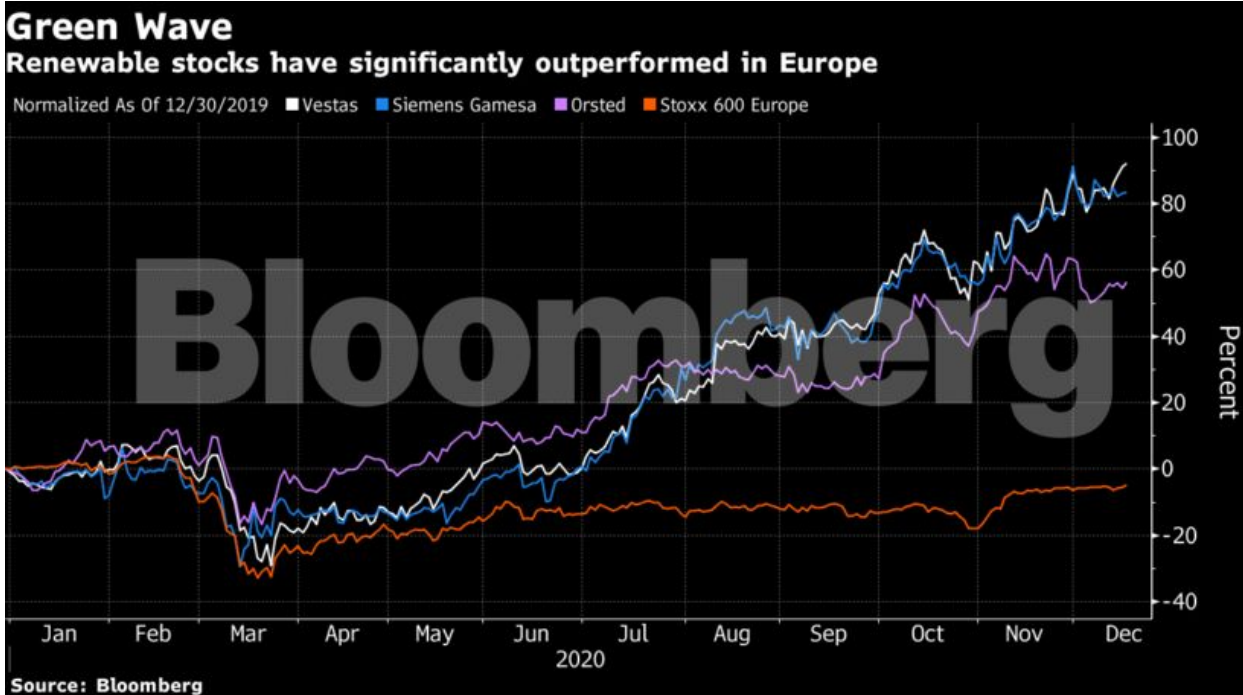
BY SØREN RATHLOU TOP

Published: 17.12.20 at 10:32

Helped by government policies such as the European Union's Green Deal and investors' environmental, social and governance concerns, renewable assets have strongly outperformed traditional utilities peers this year in the Stoxx Europe 600 Index. Turbine maker Vestas Wind Systems A/S has almost doubled in value, while U.K. electric company SSE Plc is up less than 3 percent.

Some strategists warn that opportunities in wind and solar stocks may be more uneven in 2021 as valuations appear stretched. Utilities may be a lower-risk way to buy into green energy growth than renewables equities, said Ursula Tonkin, head of listed strategies at infrastructure investor Whitehelm Capital Pty Ltd.

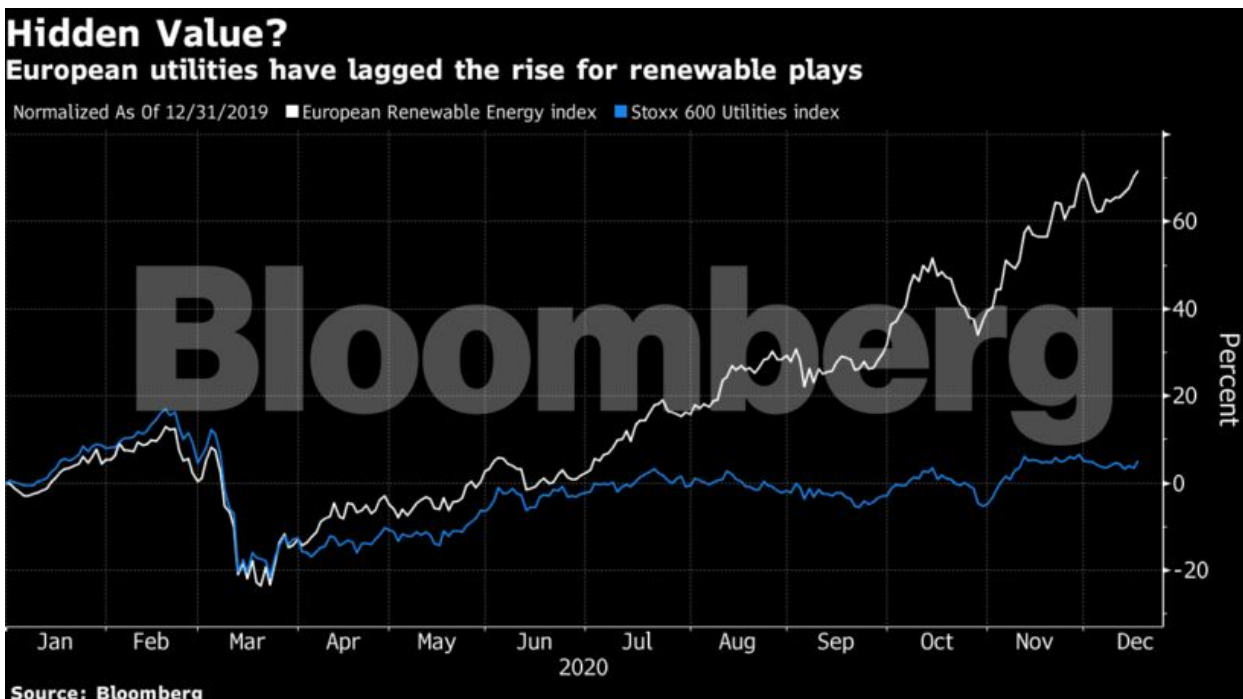
"Over the long run, the tortoise will likely outperform the hare," she said. "For every new solar, wind or battery installation, the grid has to expand to accommodate it."



While coronavirus-pandemic winners such as tech shares are losing favor in the latest vaccine-fueled stock rally, sustainable companies have stayed in favor, also helped by November’s U.S. presidential election victory for Joe Biden, who pledged a clean-energy agenda. Still, utilities as a whole have gained only modestly so far this year.

Many utilities have positioned themselves to capitalize on opportunities in green energy after “cleaning up” their portfolios in the past few years, said Sam Arie, an analyst for the industry at UBS AG.

“We’ve gone from a world five years ago which didn’t really have climate goals in view to one where now those are the most important goals across all the sectors,” he said.



Investors will have to be more selective, with next year unlikely to be as “exceptional” as 2020 for the renewables segment, said Louise Dudley, a global equities portfolio manager at Federated Hermes Inc. Stocks such as Orsted A/S trade at about 53 times estimated earnings, versus 19 times for the Stoxx 600 Utilities Index. The Danish offshore wind-farm developer was recently downgraded at Bank of America Corp. and Royal Bank of Canada.

Investors are giving “insufficient credit” to utilities like SSE, Germany’s RWE AG, and Portugal’s EDP SA that balance spending on renewables with defensive earnings flow from electricity networks, RBC Capital analysts said in a 2021 outlook note for the utilities sector. Analysts tracked by Bloomberg see 16% upside for RWE and 6% for EDP, while average price targets are for at least 11% declines for Vestas and peer Siemens Gamesa Renewable Energy SA.

Another plus is attractive payouts. Investors would struggle to find another industry that delivers utilities’ highly predictable, strong earnings growth alongside comparatively high dividend yields, UBS’s Arie said.

Still, while 2021 may involve a “bumpier ride” for renewables, valuations for Vestas, Orsted and peers aren’t likely to slide as their business growth forecasts are so positive, Whitehelm Capital’s Tonkin said.

Green Competition

An additional concern for the pure renewables industry in 2021 is increasing competition, both from utilities ramping up spending and oil companies aggressively investing in green energy. This could pose a “real threat” to the economics of wind and solar, said Ulrik Fugmann, co-head of the Environmental Strategies Group at BNP Paribas Asset Management.

Fugmann manages the BNP Paribas Energy Transition Fund which has returned more than 132 percent in 2020, attracting many new investors in recent weeks with AUM growing by EUR 500m between 19 November and 8 December.

Others, however, are sanguine. James Smith, fund manager at the Premier Miton Global Renewables Trust, said oil companies that “seek projects simply for the sake of it” would put returns at risk at a time when the sector must strike a balance between operating core crude-oil assets, executing the shift to renewables and paying dividends.

The energy market “needs to grow very aggressively in the next two decades” to reach regulators’ emission-cutting goals, said Harry Boyle, a portfolio specialist at sustainability-focused fund manager Impax Asset Management. “There should be ample room for all actors.”

Additional editing by Søren Rathlou Top