Green bonds find their purple patch in golden era

Toyota was twice oversubscribed in financing sales of zero-emission cars such as the new FCV, displayed by Toyota managing officer Satoshi Ogiso

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Green and Climate Bonds make good investment sense

STIRLING LARKIN
GLOBAL INVESTOR

IN the last month, when the Australian carbon tax has been a subject of red-hot global debate, a far more important announcement out of London has, until now, gone unnoticed.

The world's first Green Bond Index was launched on July 1 by the British bank Barclays in conjunction with MSCI, one of the leading global financial services information providers.

This is a critically important milestone, as it finally brings Green and Climate derived investment products into the fold.

This development will also provide numerous opportunities for not only Institutional and Ultra High Net Worth (UHNW) investors but also, in time, for the broader investment community.

It appears that Green Bonds have found their purple patch and issuers are welcoming this newfound golden era.

According to the World Bank, global issuances are rapidly increasing from $US3 billion in 2012 to nearly $US50bn by the end of this year. Some also believe that Green Bonds will account for around 15 per cent of the entire global bond market by 2020.

We all know that the environment matters.

The important question then becomes whether so-called "Green" products actually help or do not.

This is the question, asked regularly but rarely answered and that, in itself, is what we now need to focus upon — the question of legitimacy.

The interim Murray Report, this week, highlighted that Australian SMSFs and retirees need a better pipeline of "mandated income products" and as bonds are the ultimate fixed income solution, this topic should be prioritised by Australian investors.

Alongside Green Bonds, Climate Bonds also appear to be rapidly increasing in issuance, acceptance and popularity. Several high profile global issuances of these bonds have been oversubscribed significantly in recent months.

Toyota, for instance, recently was twice oversubscribed for their $US2bn face value of bonds issued to help finance sales of zero-emission cars.

In April, the French regional government that oversees Paris, Ile-de-France, issued their second Green Bond, seeking €350 million but after one hour, closed with €750m of orders and ended up issuing €600m.

Whereas Green Bonds raise the finances for an environmental project, Climate Bonds raise finances for investments in emission reduction or climate changing adaptions.

Importantly, in attempting to answer the question of legitimacy in 2014, a vast majority of Green Bonds are still issued by the World Bank, compared to most Climate Bonds, which are issued by private sector corporations.

This becomes important because, even now, there is no unified agreement upon what constitutes a Green or Climate friendly product.

The World Bank's Green Bond eligibility framework does not currently extend to private sector issuances in either Green or Climate products.

As Australian SMSF portfolios are both directly and indirectly allocated greater exposures to this subcategory, so too is the importance of answering these concerns.

Australia's UniSuper has recently become the cornerstone investor in the World Bank's first Australian Green Bond issue and this highlights one example of why Australian investors need to pay more attention to this "thematic".

Another interesting point to note is that the World Bank, for whatever reason, still publishes the names of all investors in their Green Bonds and these are publicly accessible via their website.

Albeit although many of us may like to be publicly recognised for supporting environmental causes, this practice appears inconsistent with 21st century privacy and professional standards.

As this subsector still appears to be largely self-regulated, another conundrum global investors face is whether buying a Green Bond from an oil company, for example, is appropriate or whether there are boundaries that both industry and investors should respect.

As North American and Chinese private companies dramatically increase their issuance of renewable energy focused Climate Bonds, without an agreed multilateral framework, the global investor will need to decide for themselves what meets their threshold for "Green" and what does not.

Many of the lessons learnt through the GFC subprime real estate product experience can now be called upon.

Some discerning global investors preceding the GFC learnt how to differentiate risk-adjusted subprime opportunities from those which were blatantly risky, in what was then an unregulated and non-standardised marketplace, just as the Green and Climate bond market is today.

Nevertheless, this month's announcement of a standardised Green Bond international index finally helps put some structure around this investment theme.

Initially "bespoke" for institutional participation, it will, no doubt, in very due course, provide a benchmark for all.

As the Australian body politic endlessly debates the carbon tax issue, the global "realpolitik" moves towards these genuine market-led environmental solutions.

As investors, the time is now to alter our focus from domestic distractions and seek global ways in which we also can address these issues through our own investment decisions.

In Britain, Germany and France, almost all Climate Bonds issued have attempted to address transport and logistic efficiencies.

In the US and Japan, around half are for these issues and the remaining half focused on renewable energies and related efficiencies.

In contrast, it is said that nearly all of China's Climate Bonds are fixed on energy investments with a particular focus on renewables.

The first yuan denominated Green Bond was issued last month and has already been very well received globally by institutional investors.

This, in itself, is an important development not only for Green products but also the internationalisation of China's renminbi.

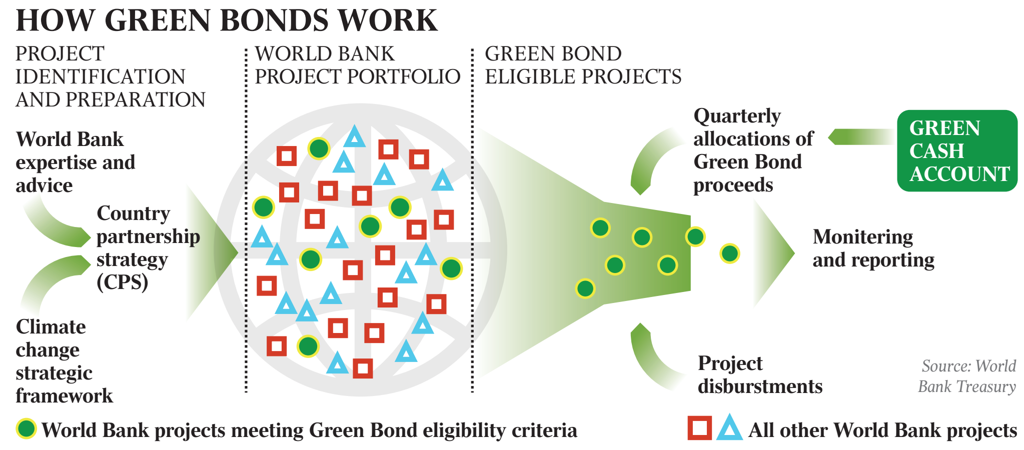
Wherever we stand on the question of climate change, one thing cannot be disagreed — that contributing to better efficiencies, smarter projects and clever processes that produce a lighter footprint on our surroundings is good business and smart investing.

As it is coincidently becoming clearer too that many Australians need to seek out more reliable income streams than solely playing potential "Russian roulette" with higher dividend distributing Listed Equities, now is the time for Greenhorns to take the time to better understand Green and Climate products.

The Green and Climate bond markets appear to be enjoying bright blue skies ahead.

Larkin Group is a wholesale wealth adviser focusing on high yielding global investments. www.larkingroup.com.au

HOW GREEN BONDS WORK



Litigation funder Bentham powers on

RICHARD HEMMING
UNDER THE RADAR

ALTHOUGH the survivors of Black Saturday's worst fire could receive a share of the record $500 million class action settlement, there are also ramifications for the electricity company SP AusNet, and for the litigation funder Bentham IMF.

The fire in Kilmore East, Victoria, in early February, 2009 destroyed about 1200 homes and caused 119 deaths. It came about because of the sparks of an SP AusNet-owned and operated power line.

This is the electricity company's second settlement of three claims relating to bushfires. Its proportion of the settlement this time was 77 per cent of the claim size, and will be met by its insurers.

The utility maintains it was not responsible for the fire and still has a claim pending over the Murrindindi bushfire, which destroyed 500 homes and cost 40 lives, but broker Macquarie hailed the recent settlement as "positive" because together the Beechworth and Kilmore fires amount to claims of close to $400m.

The broker added that there was "still ample coverage" within its insurance policy to meet the subsequent claims, which it expects to settle.

SP AusNet's shares have remained relatively flat since the news last week, maintaining its market cap of $4.6 billion.

The Kilmore East matter was run by Maurice Blackburn Lawyers who will benefit financially from the decision, but in Under the Radar's opinion, an even bigger beneficiary over the longer term is Bentham IMF (ASX code: IMF), which has collected $1.4bn for clients since its formation 13 years ago as the first significant entrant in litigation funding (in the world).

Its market cap is $322m and it has established a leading position in Australia.

SP AusNet has a dividend yield of just over 6 per cent, which is more than Bentham IMF's more unpredictable one, which we estimate is close to 5 per cent, but even Macquarie would admit that there is limited return for shareholders beyond SP AusNet's yield.

Australia's power needs are declining, not climbing.

In contrast, as Kilmore East amply demonstrates, the world's propensity for litigation continues, as ever, to be strong. And we like Bentham IMF's business model, which we believe is akin to funds management.

Bentham IMF does have a modest amount of debt on its balance sheet. But in order to generate a return on equity of about 9 per cent, infrastructure company SP AusNet relies heavily on credit, with a gearing or net debt to equity ratio of about 175 per cent.

I know which company I prefer.

Richard Hemming is an independent analyst who edits a fortnightly newsletter www.undertheradarreport.com.au. He does not own shares in any of the companies mentioned.

Free-to-airs won't win this game

ROGER MONTGOMERY

THE Ten Network is attempting to reboot one of the more popular TV game shows of the 70s and 80s to fill its 6pm prime-time schedule. After a number of unsuccessful program selections, the broadcaster is hoping to boost its ratings by reintroducing *Family Feud*, an American game show that first premiered in 1977 on the Nine Network.

For those of you who haven't watched the show for a while, perhaps we could play a quick version of the game today. "Can you name three major Australian free-to-air television stations potentially facing technological disruption from online competition?"

At Montgomery Investment Management, we have previously likened the free-to-air TV market as three brusque men locked in a room with no windows playing a perpetual game of cards. Each ratings season represents a hand that is dealt and must be played. Sometimes Seven gets a good hand, but next time it will be Ten and then after that it will be Nine. The order doesn't matter much and the stakes don't get any bigger.

The three major players have been playing this game for as long as we can remember, due to the significant barriers to entry of building a national broadcasting network. However, the rise of the internet has allowed online content providers to enter the card game, and it's likely that they may take a fair amount of the pot in time.

While video content has always been accessible online, it is only in recent years that internet service providers could deliver sufficient capacity to allow streaming. This means that the viewer can watch a video online in real time, rather than downloading the file on to their computer and watching it later. Television networks do not own the majority of content that is broadcasted, which means their business model is under serious threat if comparable competitors can distribute this content more efficiently.

Netflix is one such competitor that can't be ignored. It's rumoured that the US-based video streaming provider will be here next year, having already captured in excess of 48 million global members. Netflix allows users to watch an unlimited amount of television series and movies for $US8.99 ($9.60) per month. The content is commercial-free and accessible on any device that is connected to the internet.

Netflix has been able to quickly respond to the changing viewing preferences of consumers. The consumption of video has become very personal, with users demanding the freedom to choose when and how to watch their favourite programs. We feel that the commercial stations have been slow to adapt to this change. How often do families come together these days to watch the same game show?

Australian commercial stations lack the scale to generate their own content with mass appeal, which means there is little they can do to retain customers if they cede control of their core product. In contrast, Netflix is highly profitable and able to produce original content such as *House Of Cards* and *Orange is the New Black*. These shows not only entice new members, but encourage them to watch further content from their extensive library.

It seems the only drawcard that could prevent the commercial stations from losing this technological battle is Australia's love of sport. Free-to-air stations have first refusal to broadcast certain major sporting events. This was to prevent paid-subscription stations from exclusively controlling the content. But even this barrier may not be as defensible as once thought.

This legislation may have made sense when paid-subscription providers could charge premium prices due to minimal competition. But today, a subscription to Netflix is considerably cheaper than even an entry-level Foxtel package.

This disparity should continue to widen as more online players enter the space. Telstra Bigpond, iiNet Fetch and Quickflix are all scrambling for a piece of the online streaming pie, which may eventually result in the repeal of the anti-siphoning laws.

But even if the legislation remains, will the Australian market be able to continue to support three commercial stations on sport alone?

Either way, we feel this is one game that the free-to-air channels will not win.

Roger Montgomery is the founder of Montgomery Investment Management.