How Will You COPE in a Clean-Energy World?

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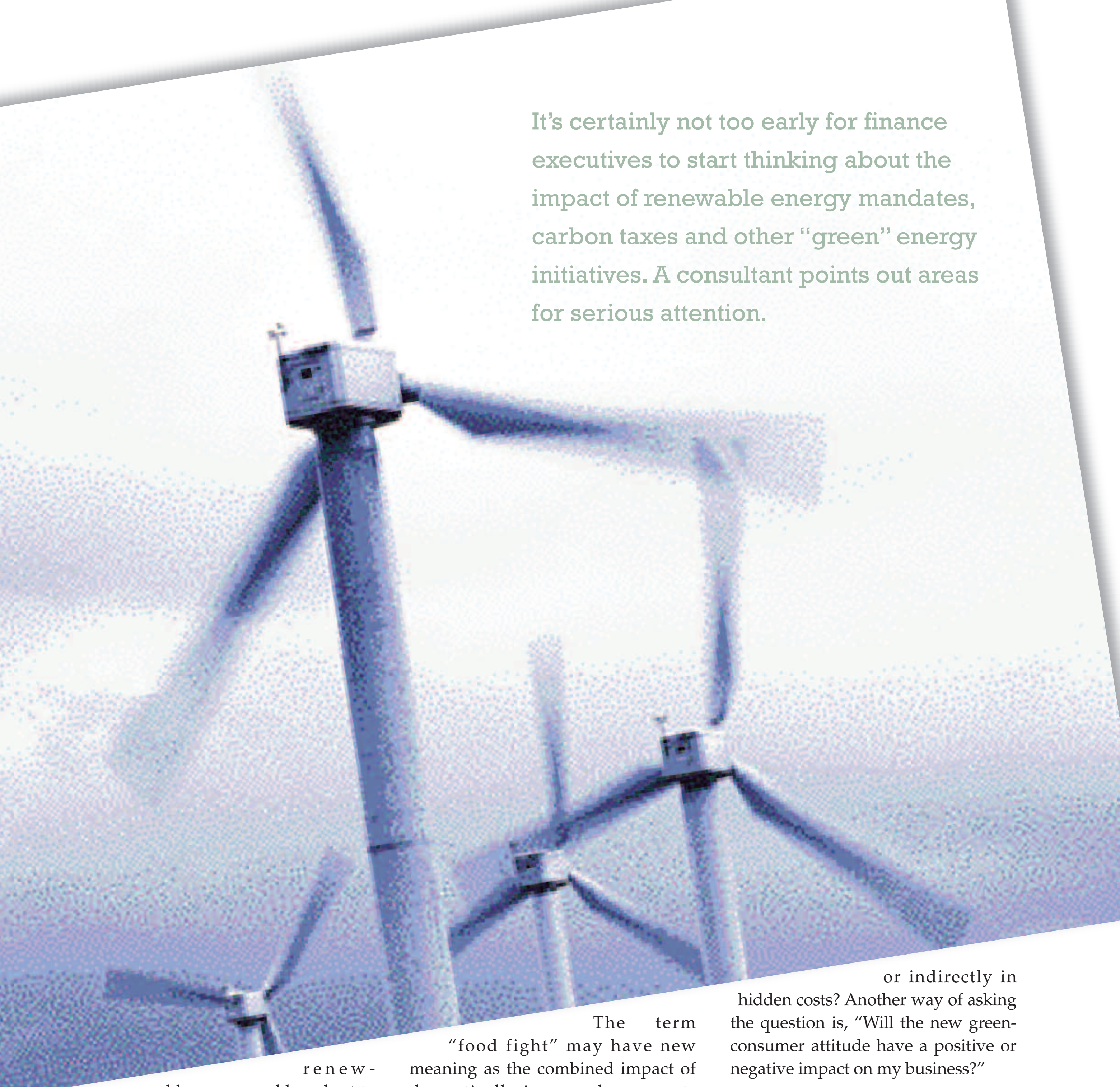
By Gary W. Patterson

How would your company's operating costs and/or bottom line be affected by: $5-a-gallon gasoline, a carbon tax or cap-and-trade system, or your power supplier being mandated to provide a geometric increase in the percentage of renewable power? Traditional industries, particularly supply chain companies, need to start planning for this "energy shift."

After attending the second annual "Renewable Energy Finance & Investment Summit" earlier this year in Phoenix, this writer gleaned seven critical concerns that may directly or indirectly affect an old-economy industry in its attempt to compete in a clean-energy world.

Although renewable energy advocates admit that it's too early to predict how renewable energy will play out in the global economy over the next decade, nonetheless they assert that the industries that are best prepared to meet the energy challenge will stand to benefit the most. In this regard, the seven areas of concern are intended to get senior management thinking strategically about the issues of

It's certainly not too early for finance executives to start thinking about the impact of renewable energy mandates, carbon taxes and other "green" energy initiatives. A consultant points out areas for serious attention.



renewable energy and how best to prepare for the opportunities and challenges that lie ahead.

1. The Rising Cost of Ethanol Production Can Affect Your Bottom Line. As a sign of the times, the energy and agriculture industries are undergoing transformational changes of historical magnitude in their efforts to produce alternative non-fossil fuel sources. We're already seeing the effect that increased ethanol production is having on many businesses: The term "food fight" may have new meaning as the combined impact of dramatically increased corn costs and restricted availability unfold across industries.

For those who haven't been to the movies lately, you may be shocked to know that the cost of popcorn has risen 40 percent since 2006. The skyrocketing cost of milk is another example of how ethanol use is affecting consumer products. Of course, the wild card here is how much more are consumers who say they want green energy willing to pay for your products or services, either directly in taxes or indirectly in hidden costs? Another way of asking the question is, "Will the new green-consumer attitude have a positive or negative impact on my business?"

2. Clean-Energy Subsidies Are Creating Both Opportunities and Challenges. Clean-energy initiatives are moving at a faster clip than originally expected: Renewable energy advocates predict that within five years, such initiatives will make economic sense on a non-subsidized basis. While this prediction may be optimistic, it's a fact that larger-scale manufacturers, sooner rather than later, will be adversely affected when they are left to deal with clean energy without the benefit of receiving government subsidies, either in the form of a tax credit or a grant.

Thus, how businesses use this "subsidized window of opportunity" today will affect their competitive position tomorrow, when clean energy becomes *de rigueur.* In the face of present and projected government subsidies, you need to ask how your company plans to leverage federal and state tax benefits. In other words, are you taking advantage of this grace period to build green-energy facilities and processes?

3. Clean-Energy Projects May "Crowd Out" Your Financing Needs. A huge amount of financing will be required for targeted and foreseeable clean-energy projects — beginning now, both domestically and globally. The magnitude of those projected financing opportunities is creating a demand that many businesses have not foreseen in their recent updates of financial rates.

Some may remember the 1970s, when regulatory changes, combined with increased demand for financing, created a "crowding out" effect: 18 percent home mortgage rates and 21 percent short-term interest rates for businesses were the norm. Looking back, it took less than a year for interest rates to rise to those levels. Fast forward to the present to witness how funding clean-energy projects seems to be getting more attractive and easier than retrofitting older facilities.

For those who say it will not happen again and the world is awash with liquidity, major regulatory changes often create unintended consequences and long-term uncertainties. This is exactly what is happening to the agricultural sector, where capital investment requirements are encouraging a growth in bigger corporate ownership rather than the traditional individual or family operations.

Given this scenario, you need to ask how a change in funding availability and higher interest rates will affect your business. For example, what impact would a 1 percent coupon-rate increase have on your operations?

4. Bulk Shippers' "Clean-Energy" Customers Could Derail Your Business. Rail and barge companies have traditionally provided transportation capacity for bulk commodities ranging from coal to grain. Today, as the demand for corn and grain shipments increases, bulk shippers (and, to a lesser degree, trucks) are seeing their client profile change from traditional manufacturers (read: dirty-energy clients) to clean-energy clients.

It won't be long before we see the two types of clients jockeying for transportation rights. Transportation capital investment plans are already being affected by requests for new or upgraded facilities to service clean-energy plants.

For many businesses, shipment costs are buried inside other costs, so these expenses may not yet be visible at the senior-executive level. Thus, you need to ask your purchasing and transportation departments to look into what is happening or is likely to happen to your shipping costs in the near future. In this regard, how would either increased shipping costs or longer delivery timeframes affect your business vis-à-vis the competition?

5. A Carbon-Effect Economy Is Taking Hold. The likelihood of a carbon credit (read: carbon tax) is increasing worldwide and among industrial giants. Although the U.S. is not a signatory, individual states (including California, Washington, Texas, Illinois, Pennsylvania, New York, Connecticut and Massachusetts) are already supporting voluntary initiatives or at least renewable electricity standards. You may be surprised to see targeted initiatives for your state on the National Renewable Energy Laboratory website (*www.nrel.gov*).

In addition, industry-leading companies such as Bank of America Corp., Toyota Motor Corp. and Wal-Mart Stores Inc. are publicizing their green-energy positions and setting new energy standards. For example, Wal-Mart recently announced that it was installing solar panels to provide as much as 30 percent of the power for its 22 stores in California and Hawaii.

As more companies will be forced to follow in the footsteps of industry leaders, how will your company absorb higher costs as they pertain to new energy compliance requirements, or indirectly in taxes (whether it's called a tax or a carbon credit)?

6. The Consequences of Rising Electricity Costs. According to the U.S. Energy Information Agency, homes and commercial buildings currently account for 71 percent of U.S. electricity usage. This number is expected to rise to 75 percent by 2025. Rising usage is already affecting some industries, as well as consumers.

For example, commercial builders are beginning to seriously consider the benefits of installing solar rooftops. Furthermore, one of the fallouts of rising electricity costs may be reduced square footage of the average size of a new residential construction.

Consumers, too, are taking proactive steps to control, and even reduce, their household electric bills by buying energy-efficient products (such as refrigerators, dishwashers, washers and dryers) and opting for fluorescent light bulbs over incandescent bulbs. On the opportunity side of this issue, will your company be in a position to manufacture and sell new and improved products that are more energy efficient? Also, what can your company do in the foreseeable future to reduce electricity consumption at its commercial facilities?

7. Clean Energy Is Preempting Consumption of Water Resources. Ethanol and biomass plants, in particular, require substantial amounts of water on a consistent operating basis. While this may come as a surprise to some, there is the issue of disposing of byproducts and waste from clean-energy production, which involves high levels of water usage.

Even before these new demands on water availability, there have been spirited arguments concerning who gets water and at what price. With plants being built in more areas outside of the Midwest, the issue of water allocation, availability and price will escalate. In this regard, how would higher water rates, or even allocated water consumption, affect your business or your competitors?

While it's too early to predict exactly which moving parts of the traditional and new energy industries will interconnect to create a new energy order, one thing is clear: Executives need to use this "window of opportunity" to encourage their management teams to take at least one action to either a) tap or exploit new opportunities or b) solve what previously may have been a nonexistent or invisible problem.

Of course, your evaluation of where you stand on these clean-energy issues depends upon the strength of your core business. If you're ready to take the next step, write down at least one opportunity or change needed. Trust your initial intuition and take action.

Gary W. Patterson, *FiscalDoctor (www.FiscalDoctor.com), is an FEI member and consultant specializing in enhancing growth and profitability. His clients include both traditional and high-tech, high-growth industries, including clean energy. He can be reached at 781.237.3637 or at gary@FiscalDoctor.com.*

TakeAways

>> While many changes to energy delivery may not be imminent, the industries that are best prepared to meet the energy challenge will stand to benefit the most.

>> The surge of ethanol and its impact on corn production (and product costs) is providing a very meaningful example of how new technologies can have widespread impact.

>> A huge amount of financing will be required for targeted and foreseeable clean-energy projects, both domestically and globally. This could have the effect of "crowding out" business borrowers and driving up rates.

>> Issues like carbon taxes and renewable electricity initiatives are already being felt in some areas, and clean-energy generation threatens to escalate demand for water.