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Stocks that make others green with envy

Environmental and energy investments may provide some good opportunities for those looking for a new place to put their money

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The prognosis doesn't look good.

Our climate is warming. Clean water is getting more expensive. Oil this month breached the \$100-(U.S.)-a-barrel tipping point, and there's even talk of it reaching \$150 within a couple of years.

Throughout all this, stellar economic growth in China is rapidly consuming global resources and threatening world energy security, while an expected slowdown in the United States economy preys on inefficient industries.

Environmental and energy challenges facing the planet may spell trouble ahead, but for investors looking for places to park their money over the coming years it could prove to be an unprecedented opportunity – if you can separate the leaders from the lemmings.

Like any investment, alternative energy stocks carry risks, but experts see positive signs ahead in this sector.

"You are looking at an unstoppable, global mega-trend for limited resources, the environment and energy," says Rafael Coven, managing director of Cleantech Indices LLC and the first stock market index of publicly traded clean-technology companies.

The company's Cleantech Index, launched in 2006 in partnership with the American Stock Exchange, tracks 47 companies that earn a lion's share of their revenues from "green" technology products and services.

"We're in the first inning of a 100-inning ballgame," adds Coven. "And let's face it, the surging population of India isn't going away, China and its environmental issues aren't going away and climate change isn't going away."

This reality, combined with the likely arrival of carbon taxes, has focused attention on technologies, services and business models that help us use energy more efficiently, promote the conservation of resources, reduce waste and lower emissions of

greenhouse gases in a way that's good for both the bottom line and the planet.

Whether it's companies that make silicon for solar panels, build wind farms on the ocean or design software for managing the smart grid, the assumption is that demand for such products has nowhere to go but up as corporations, governments and consumers go green. Any publicly traded company in that supply chain can ride the wave.

The challenge, says MacMurray Whale, an alternative energy analyst with Cormark Securities in Toronto, is to distinguish between good businesses that will pay off over the long haul and good stocks that rise quickly on a promise and fall just as fast when they fail to deliver.

"You basically stick with leaders in a market until there's a sign to do otherwise, because the leaders typically outperform the laggards over the long run," says Whale.

The Cleantech Index aims to track the global leaders in the pack. Investors who want to play the index can buy U.S. units of the PowerShares Cleantech Portfolio, an exchange-traded fund that has increased 33 per cent since Jan. 1, 2007. It has far outperformed both the S&P 500 and Nasdaq composite.

Coven calls the PowerShares fund a long-term growth stock that has the diversification offered by a mutual fund but with a fee of just 0.7 per cent – less than a third of most mutual funds.

Part of the fund's success last year was its 22 per cent exposure to companies involved in solar technologies, such as SunPower Corp., First Solar Inc. and Suntech Power Holdings Co.

Production of solar panels grew 50 per cent in 2007 and has been doubling every two years since 2002 with no signs of slowing down. This means enormous demand for the materials that make the solar cells that make the panels that make the modules. It also means demand for companies that can install, maintain and eventually recycle these solar-energy systems.

The Washington-based Earth Policy Institute estimates that by 2010 the production costs of newer "thin-film" solar PV modules will reach \$1 per watt, "at which point solar PV will become competitive with coal-fired electricity."

But amid the opportunity there can also be over-exuberance. The solar market got too hot last year, and after a long run-up analysts began labelling many of the stocks overvalued. SunPower, First Solar and Suntech each lost more than 20 per cent of their value in the first two weeks of January alone.

Biofuel stocks took a plunge for the same reason.

"Investor expectations got ahead of themselves in solar and biofuels," says Coven, who at the beginning of the year rebalanced the index to reflect the correction. Solar's exposure in the fund has been cut in half to 11 per cent. "And we have no exposure now to biofuels."

Coven said energy-related stocks represent about 40 per cent of the index but there's heavier weight these days on energy efficiency, energy management and smart-grid stocks.

This includes companies that can take advantage of the desperate need to modernize the world's aging electricity systems, and that offer ways for the corporate, industrial and government sectors to operate more efficiently, conserve energy and in turn keep energy costs under control – all attractive objectives during recessionary times.

Stock in companies with water-related technologies represent about 10 per cent of the fund. One theme through all 47 stocks: "companies with real earnings," says Coven.

If you're more risk-averse and like the idea of a fund being more actively managed, particularly during an economic slowdown, a mutual fund might work better – if you can find one.

Recognizing that such a product wasn't available in Canada, Criterion Investments Ltd., an affiliate of VenGrowth Asset Management Inc. of Toronto, launched in September what it dubs a Canadian first – a global clean-energy fund giving Canadian investors access to dozens of the world's top companies in the sector.

"We're very bullish on the prospects of this fund," says Ian McPherson, president of Criterion. "The interest level is certainly increasing."

The company's RRSP-eligible Criterion Global Clean Energy fund is managed out of Geneva by Pictet Asset Management SA, which expects the clean energy sector to outperform the economy as a whole. The fund is also available throughout Europe and parts of Asia.

Investments in the fund include Vestas of Denmark and Spain-based Gamesa, two of the world's leading wind-turbine developers, and Renewable Energy Corp., or REC, a top supplier of polysilicon solar wafers and cells. Pictet doesn't invest in nuclear technology companies.

The fees, ranging from 2.65 to 2.75 per cent depending on whether one chooses the currency-hedged option, are higher than the PowerShares ETF. But McPherson argues that active management lowers the risk, particularly as the U.S. economy looks forward to a slowdown, and possibly a recession.

"I think the market is so dynamic right now, one has to have a good command over different geographies, because there are tax incentives and policy incentives in different places," he says, adding that in such an environment it would be unwise to go the opposite extreme and directly invest in individual stocks.

"It's too difficult to be an individual stock picker and take that undue risk. This is a time when you want diversification within solar, wind, geothermal, energy efficiency and biofuels."

Coven agrees. "I'm very cynical about the average investor trying to beat the market."

McPherson concedes, however, that people are being cautious about when to invest in

mutual funds and "picking their timing" carefully. Still, as Coven suggests, he considers investment in the clean-energy sector somewhat recession-proof.

"The profit models are being driven by slightly different economics than the global economics cycle," McPherson explains.

"That's what makes it a bit more attractive. Everyone knows there are good contracts out there, and spending going on in areas regardless of whether the economy is in recession or in super-growth mode."

Cormark's Whale, however, says the more experienced investor might want to pick a few leaders in the sector and hang tight. If you're keen on sticking with Canadian stocks, however, he warns against picking pure technology companies that have failed to demonstrate a path to earnings.

"I just don't think many of the Canadian companies are going to be competitive," says Whale, pointing to disappointing performances and missteps from flow-battery maker VRB Power, hybrid-locomotive supplier Railpower and even solar-LED company Carmanah Technologies.

Whale advises a focus on clean-energy developers, such as Montreal-based wind developer Boralex, Vancouver-based run-of-river hydroelectric developer Plutonic Power and offshore wind developer Naikun Wind Development, also of Vancouver.

Such service companies are taking advantage of renewable energy contracts being awarded in British Columbia, Quebec and Ontario, and are shielded against foreign competitors in the United States and China.

"If you own a basket of them, I bet that basket does well this year," says Whale.

On the technology side, he says power electronics developer Xantrex Technology of Vancouver and Montreal-based 5N Plus, which purifies metals for the solar industry, are two rare shining lights on the Toronto Stock Exchange.

"But you'll make more money on power developers than you will on technology stocks," says Whale.