

ALTERNATIVE ENERGY GROWS UP

Investing in energy companies a year and a half ago has turned out to be a good move: oil exploration and development companies, drillers, refiners, and natural gas pipelines have all performed spectacularly since then. I think companies in these industries will continue to be quite profitable, as long as the strong demand for them continues, and supplies diminish.

But we are way overdue to come up with some realistic alternatives to petroleum products. (By alternatives, I am not including nuclear power plants, as I believe our ability to control quantum energy run amok is unconscionably minimal compared to the potential devastation and deadly waste materials.) Investors are beginning to recognize this need for alternative energy products and systems, and they are investing in companies dedicated to developing energy-efficient technologies and products. (And, lo and behold, the Bush administration announced two days ago its plan to unveil “a national campaign to encourage energy conservation”.)

Alternative energy investment choices have increased in number in the last few years, and they have “grown up” to be viable companies beyond the start-up stage. Some are even profitable now. Here are some recommendations for those of you so inclined to invest in this industry.

Exchange Traded Fund (ETF): PowerShares Wilderhill Clean Energy Portfolio (PBW, \$17)

ETFs are a relatively new kind of investment, sort of a hybrid of mutual fund and individual stock investing. They are described in detail under Security Types on the www.fizone.com web site. Briefly, an ETF allows you to buy or sell throughout the trading day a basket of categorized stocks; it's easy to identify the stocks in your basket, and they seldom change; taxes are incurred only when you sell the ETF.

The Wilderhill Clean Energy portfolio replicates the index of the same name and contains close to 40 U.S. stocks, chosen because they are involved in promoting the use of cleaner energy and/or conservation. Because of conservation and clean energy's rather short history, 84% of the companies in the portfolio are small cap stocks (shares outstanding times price per share is under \$1 billion). Almost half of the portfolio components are industrial businesses and more than a quarter are information technology companies.

The top 4 holdings (all industrials), which represent 20% of the portfolio, are, in order of representation in the portfolio: Capstone Turbine, Energy Conversion Devices, Distributed Energy Systems, and UQM Technologies.

Capstone Turbine (CPST, \$3): produces microturbines, which use gas or liquid fuels and can be used in hybrid electric vehicles as auxiliaries to batteries; company has negative earnings.

Energy Conversion Devices (ENER, \$44): invents, develops proprietary new materials, products, and technology, called “ovonic”, in areas of information technology, energy generation, and energy storage. The company has hundreds of alternative energy patents and uses joint ventures and licensing agreements to achieve its strategy; has earnings of \$1.62 per share.

Distributed Energy Systems (DESC, \$8): parent of Proton Energy Systems, which develops hydrogen production and fuel cell technologies, and Northern Power Systems, which manages projects in renewable energy, advanced combustion, and batteries, has negative earnings.

UQM Technologies (UQM, \$4): develops energy-efficient electric motors for vehicles such as wheelchairs, golf carts, and industrial utility vehicles; has negative earnings.

The above companies may not be what you had in mind as pure-play alternative energy, but all are involved in non-petroleum energy or non-conventional systems of providing energy. In the portfolio **Evergreen Solar (ESLR, 3.19%)** is the only pure solar technology company, while others are involved in solar energy as part of their business model. **Ormat Technologies (ORA, 3.42%)** develops, owns, and operates environmentally friendly geothermal power plants. Many of the companies are involved in fuel cell development, like **Ballard Power Systems (BLDP, 2.48%)**, which makes zero-emission, proton exchange fuel cells.

Individual Stocks

Because most of the companies in this sector are small cap, fundamentals are generally weaker than more mature companies, and information is more difficult to find. If you prefer to zero in on the best individual stock(s) in this sector, based on investment fundamentals, I have summarized some basic data on what I feel are the most sound investments of the group:

International Rectifier (IRF, \$45) – At \$3 billion in market cap, this maker of power management and power conservation products is one of the larger stocks in the ETF and in the sector. The growth outlook (25% annually) and earnings strength (\$1.91 for the last 12 months, \$2.33 and \$2.85 estimated for next year and the following year) are the strongest of the group. The P/E and P/E-to-growth ratios suggest the stock is undervalued at its current \$45. S&P has a Strong Buy recommendation with a \$63 price target.

American Power Conversion (APCC, \$25) – This company is not really an *alternative* energy company in my opinion. It makes power protection devices, such as surge protection and uninterruptible power supply products. At \$5 billion market cap, it's the largest on my list. It has solid earnings—estimates are for \$.98 next year and \$1.17 the following year—and a 15% anticipated annual growth rate. S&P rates it a Hold with a \$30 price target.

Ormat Technologies (ORA, \$22) – This geothermal power plant operator is a small cap enterprise with consistent earnings. Its business model is completely environmentally friendly and includes compact power plants for remote sites, and plans to operate recovered energy power plants. Their plants are installed in Hawaii, California, New Zealand, and several other countries. Fundamentals are mixed, with debt-to-equity and price-to-sale ratios a little high, and annual growth estimated to be a healthy 14% over the next five years. Also contributing to profits are contracts to sell power from their plants.

Energy Conversion Devices (ENER, \$44) – This \$1 billion company, described briefly earlier, has no debt, a healthy profit margin, and a recently announced joint venture with China for a solar manufacturing operation there. Their unique Ovonic solar technology does not use silicon, an advantage because of scarcity of silicon worldwide.

Evergreen Solar (ESLR, \$9) – Although a small company (\$500 million), Evergreen has increased income in each of the last five years. They have no debt, and analysts are generally optimistic about this company.

Medis Technologies (MDTL, \$17) – Fundamentally this small company (\$495 million) has little to recommend it, other than it has no debt. But it gets *honorable mention* on my list because of its promising Power Pack device. Medis's primary focus is on direct liquid fuel cell technology, but the Power Pack could be its biggest source of revenue in the near future. It is a disposable and portable charger of cell phones (up to 20 hours) and other wireless gadgets. They have lined up an assembly line manufacturer of the units, up to 1.5 million units per month. With a

\$3.00 profit margin per unit, one analyst estimates the company will make \$1.43 per share in 2007.

Make Your Own Basket

If you like the idea of investing in clean, alternative energy stocks, but aren't thrilled with the make-up of the ETF, you can choose a handful of individual companies that do meet your criteria.

For the environmental purist **Evergreen Solar (\$9)**, **Ormat Technologies (\$22)**, and **Ballard Power Systems (\$5)**, all in the ETF and described earlier, would be a good start. Another "pure-play" and also in the ETF is **FuelCell Energy (FCEL, \$10)**, whose power plants provide clean, efficient, and reliable electricity provided by its fuel cells. Only Ormat is profitable, having earned \$0.70 per share in the last 12 months and anticipated to do \$0.28 better next year. They have a substantial debt-to-equity ratio, but are expected to grow 14% annually over the next five years. Evergreen has no debt, and just had its best year, losing only \$0.04 per share, but is not expected to be profitable this year or next. Ballard may have the most intriguing product, but Standard & Poor's expects earnings to be negative for the foreseeable future. Increasing demand in Japan will help sales. (Sidenote: In 2000 the stock price was as high as \$144 per share, even though earnings were negative.) FuelCell has installed or been awarded new contracts for its Direct FuelCell power plants by a substantial number of large corporations and government agencies in the last few months, which will improve earnings; but manufacturing costs per kWh are still twice what they need to be, according to Standard & Poor's. They think it will be a few years before the company is cash flow positive.

If you are more interested in sticking with strong fundamentals, I recommend a basket of some or all of the stocks I list under **Individual Stocks**.

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1 October 2005

Sources: www.powershares.com; www.schwab.com