

By DAVE EBNER

From Saturday's Globe and Mail

It isn't easy being green, a famous frog once said, but as companies working for a cleaner planet push toward tangible profits, some observers believe the environment could emerge as the market's next big thing in the coming years.

"The sector holds enormous potential," said Ian Ihnatowycz, president of Acuity Investment Management Inc., a Toronto money manager offering a line of "clean environment" mutual funds.

Yet much promise always comes alongside much uncertainty. It's easy enough to say the areas of alternative energy, waste management and safe drinking water will boom at some point -- but when is a more difficult question, not to mention the challenge of trying to pick long-term winners.

"You can really get your head handed to you in this area," said Brian Pinch, an investment adviser at Raymond James Ltd. in Victoria. "There's blood everywhere. But that said, it's a way better time to look at these things than it was two years ago."

Fuelled by the stock mania of 1999 and early 2000, green companies soared to outlandish highs, only to collapse when the broader market fell apart. And even now, two years after the North American equity bubble burst, the broadly defined "green" sector remains wildly volatile.

Ballard Power Systems Inc., a Burnaby, B.C.-based developer of zero-emission fuel cells and Canada's best known green company, is a fine example. In the past year, Ballard shares have at various points fallen 70 per cent, climbed 160 per cent, fallen 35 per cent, climbed 40 per cent and, since early April, fallen 50 per cent.

This is what Mr. Pinch called the "white-knuckle factor," a hallmark of all potential high-growth stories. While optimistic in general, he recommended "caution." Another key, of course, is careful research, Mr. Pinch said, especially in a relatively nascent sector whose constituents are at various stages of development, addressing different markets.

"Everything looks good — but what's it worth?" Mr. Pinch said. Ballard, in the opinion of Raymond James, isn't attractive. It doesn't make money, faces increasing competition and "it's going to be a long time before you see fuel-cell cars on the road."

Westport Innovations Inc. is closer to actual profit, Mr. Pinch said, though it still loses money. The Vancouver-based company develops technology to make diesel engines run on cleaner fuels, like natural gas, and Mr. Pinch said it is "fairly far along."

Other companies, like Zenon Environmental Inc. of Oakville, Ont., are already profitable. Zenon makes a product to filter bacteria, viruses and parasites out of water, an alternative to conventional water cleaners like chlorine. In the past four quarters, Zenon posted sales of \$131-million and a \$5.3-million profit. Yet its stock is by no means cheap, trading at more than 50 times trailing 12-month profit, a valuation garnered by 50-per-cent plus profit growth and enticing potential.

Zenon is among the "buy"-rated stocks followed by Sara Elford, an analyst at Canaccord Capital Corp. in Vancouver. The company's technology, she said, competes cost-wise against older methods.

"The value has got to be there," Ms. Elford said. "A green solution won't be adopted unless it makes economic sense."

Westport, however, is further behind on the "adoption curve," Ms. Elford said. While its technology is "intriguing," she said the company is "a ways away from profitability." This is the challenge of bringing a new product to market, she explained, saying the low-margin trucking business is reluctant to take chances.

"It will take time — just because it's green doesn't mean these things will develop as quickly as we'd all like," Ms. Elford said. "It's a long process."

The growing "show-me" sentiment among investors in the broader stock markets could restrict the advances of shares in green concept companies, like Ballard and many others, she said.

"Investors' focus in the next couple years will be on companies closing in on — or selling — commercial products, generating real profitability."

Water treatment companies, like Zenon, fit this sort of focus, Ms. Elford said. Beyond Zenon, Trojan Technologies Inc. of London, Ont., is making solid strides. Trojan makes ultraviolet disinfection systems to clean water, and in the quarter ended Feb. 28, the company made \$1.1-million or 6 cents a share on \$22.7-million in sales.

"These companies are on the verge of pushing into the mainstream," Ms. Elford said. "It's not a tomorrow story. They're delivering profits today."

Still, like the Ballard stock roller coaster, shares of Zenon and Trojan are susceptible to manic runs higher and swift slides lower. Ms. Elford noted that Trojan stock has almost doubled this year and could attract profit-taking among investors, especially given the weak broader markets.

Beyond water, Ms. Elford likes Newalta Corp. of Calgary. Its stock trades at about 10 times trailing profit, a modest valuation, the result of the cyclical nature of the energy business, she said. Newalta recovers oil and materials from industrial waste in Western Canada destined for disposal, and recycles the goods for resale.

"It's cheap, the management is good and there's a growth opportunity in the next five to 10 years as the company expands in the east."

While some investors may enjoy the challenges of picking individual stocks, many others choose the mutual fund route. Funds focused on green companies remain a small niche, however.

"It's relatively new," said Kevin Towers, a financial planner at Toronto-based GP Capital Corp. "But there's a growing number of products."

Toronto's Acuity Investment Management Inc. is a veteran in the sector and offers four clean environment funds. But the funds are not "pure plays." Because the sector is not very large in Canada, the money manager invests in numerous other areas, partly for portfolio management reasons, said Martin Grosskopf, an Acuity analyst.

"There aren't enough [green] companies making consistent profits," Mr. Grosskopf said. "The reality is we're trying to invest in companies that will make us money in the next year."

Outside of pure green plays, Mr. Grosskopf said Acuity looks for "best of sector" companies. Suncor Energy Inc. is one example. The energy company takes a progressive environmental tact, Mr. Grosskopf said, when evaluated against its peers. Royal Bank of Canada is another, he added. The bank's lending standards include an environmental risk assessment to avoid possible liabilities.

In the alternative energy realm, Sentry Select Capital Corp. of Toronto sells an Alternative Energy Fund.

"The potential for growth is huge," said John Sinkins, the fund's manager. Of the world's energy use, alternative energy accounts for less than 1 per cent of the total output, Mr. Sinkins said. Even if the figure only rises modestly, companies in the sector could benefit greatly.

The fund, down more than 40 per cent in the year to May 31, has stumbled with the broader market for technology stocks. Still, the promise remains, Mr. Sinkins said.

"It's an exciting sector. It could be the next dot-com type boom."