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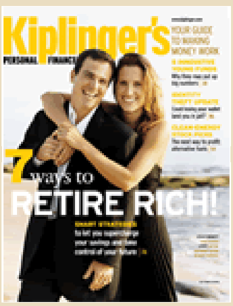


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# Clean Power Gets a Lift

*High oil prices and new tax breaks put the wind at the back of alternative-power players.*

By David Landis


From the October Issue of Kiplinger's

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Alternative- energy companies once seemed like lonely hitchhikers on a highway full of Hummers. No longer. With oil above $60 a barrel and Congress having enacted an energy bill laden with tax credits, investors are suddenly willing to give alternative-energy stocks a lift. They should be prepared for a bumpy ride ahead.

Although it's been three decades since Middle East producers first put the squeeze on U.S. oil supplies, the alternative-energy sector is still a jumble of small companies, most of which lose money. Only 15 of the 36 companies in the year-old WilderHill Clean Energy Index were profitable over the past 12 months. Alternative-energy stocks "are really speculative in nature," says T. Rowe Price analyst Wenhua Zhang, who doesn't recommend any of them. "They may be viable on hopes and dreams, but not on the basis of fundamental factors."

That's not to say there haven't been advances in producing hydroelectric power and energy from wind turbines, solar panels, fuel cells and other technologies. But some of the most successful companies in the field are huge conglomerates, such as **General Electric** (GE) and Germany's **Siemens** (SI), and big oil companies that are hedging their bets, such as England's **BP** (BP). Investing in any of these firms will give you a stake in alternative energy, albeit a relatively small one. For example, GE expects $2 billion in sales this year from the production of wind-powered turbines. That's a 300% increase since 2002, but it's still only about 1% of GE's revenues.

There's hope that technologies developed by some of the smaller players will soon become commercially viable. That will be more likely if crude oil remains at its current level. Moreover, the Energy Policy Act of 2005 promises a variety of tax credits to businesses for manufacturing energy-efficient appliances and constructing energy-efficient buildings, and to consumers for purchases of non-gasoline-powered and hybrid cars, and solar water-heating equipment.

## Better sentiment

Those developments have already put some wind behind alternative-energy stocks. Over the past year to August 19, the WilderHill Clean Energy Index gained 26%. "People are feeling better about the sector because they think there have been some positive developments," says Matthew Patsky, co-manager of Green Century Balanced fund.

Investors willing to venture into the sector should look first for profitable firms with established products. One good example is **Power Integrations** (POWI), a maker of power-saving silicon chips found in a wide variety of household and industrial products. A global drive to tighten energy-efficiency standards for computers, TVs and other appliances should be good news for this San Jose, Cal., company.

Computers still consume energy in standby, or "sleep," mode, and remote-control TVs, even when switched off, use some power. A variety of government-sponsored initiatives, such as the Environmental Protection Agency's Energy Star program, seek to minimize the use of standby power. In addition, California will impose tough new energy-efficiency standards next year on external power supplies -- those devices that recharge cell phones, iPods and other gadgets. Power Integrations, which has a leading share of the market for high-end power-supply chips, says its products meet the EPA's and California's standards, as well as standards of other nations. Shawn Slayton, an analyst for investment bank SG Cowen, says shares of Power Integrations, recently $21, should outperform Standard & Poor's 500-stock index by 20% over the next year, partly because of the business that these new energy-efficiency measures will generate.

Power Integrations is small (with a market value close to $700 million). But it is profitable (analysts see it earning 66 cents a share this year and 81 cents in 2006), and it holds $124 million in cash, a sign of good financial health.

## Coal play

Also profitable is **Fuel-Tech** (FTEK), an even smaller company (market value, $142 million) that makes cleaning and pollution-control equipment for coal-fired power plants and industrial boilers. The firm, which is chartered in the Netherlands Antilles and based in Stamford, Conn., benefits from two clashing trends: Although the U.S. has plentiful supplies of coal, it has toughened the air-quality standards for coal-burning plants. As more utilities and industrial plants turn to coal as a cheap alternative to oil and natural gas, Fuel-Tech benefits. The company says revenues could hit $48 million this year, a 55% increase over last year's total.

The stock, at $6, has doubled since December 2003. But the run-up may not be over. "We think it's a $10 stock," says Green Century's Patsky. Analysts see Fuel-Tech earning 22 cents a share this year and 35 cents next.

It's difficult to point to any surefire winners among companies that aren't yet profitable. The best approach is to buy them as a group. You can do that with a new exchange-traded fund, **PowerShares WilderHill Clean Energy Portfolio** (PBW; recent price, $15) that tracks the WilderHill index. The ETF is less than a year old and thinly traded, but it offers exposure to a variety of promising technologies, including fuel cells, and wind and solar power. No company accounts for more than 5% of assets, so the risk is fairly well dispersed. Small companies dominate the index, however, and a general retreat among small-company stocks, which have performed terrifically over the past year, could hurt the index.

*-- Research: Amy Esbenshade Hebert*

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