

Three industries picked to grow - and quickly

By Barbara Wall International Herald Tribune
SATURDAY, DECEMBER 31, 2005

Any seasoned investor can predict, with some degree of confidence, which industry sectors will be hot in 10 years. The skill is to identify the companies that will make future headlines - and to do it before Wall Street gets wind.

Your Money asked fund managers and analysts to focus on three industries that look likely to show rapid growth, and to name the companies poised to lead the charge.

Energy and the environment

In its latest World Energy Report, the International Energy Agency warned that unless business leaders embraced renewable energy sources, the planet would suffer an acute power shortage and a catastrophic increase in greenhouse-gas emissions.

The planet seems to be getting the message. Investment in renewable energy, mostly in solar and wind power, has grown from almost nothing 10 years ago to nearly \$20 billion in 2005. This is expected to increase steadily to about \$100 billion a year by 2015 as other energy sources, including tidal power and biomass, or energy from organic materials, are exploited.

The challenge is to find a stock in the clean-energy space that checks off all the right boxes: low valuation, strong cash flow, good business plan and leadership potential. It is a tough call. Clean energy is hot and many stocks in the sector have moved too far, too fast, according to some industry observers.

Michael Liebreich, director of New Energy Finance, a London-based provider of data and analysis, said he would be wary of adding to investments in solar power. "Demand for solar power will continue to grow, but the enormous capacity being added to the sector might eventually outstrip growth in demand," he warned.

Liebreich said he would feel more comfortable holding wind-power companies. "Although wind companies have also forged ahead this year, there is room for further upside," he said. "The long-term fundamentals for wind power are also encouraging. Almost every country has indicated that it will significantly increase investment in this energy source."

Still, Liebreich cautioned against buying a basket of wind-power stocks. "Investors need to identify which pure-play companies in the sector have sufficient strength in their balance sheets to become industry leaders," he said. "Over time, competition from large engineering conglomerates like Siemens and Mitsubishi will whittle away margins." He said that small-capitalization companies with modest earning streams, like Gamesa, Vestas and Suzlon, should survive a sector shake-up.

One segment of the clean-energy sector that has yet to capture the market's imagination is hydrogen fuel cells. The technology is in its infancy, but the ultimate aim is to deliver zero-emission engines.

Emma Howard Boyd, head of clean-energy investment at Jupiter Asset Management, is sufficiently impressed with developments in fuel cells that she has invested in FuelCell Energy, a pure-play company. She also holds Azure Dynamics and Quantum Fuel Systems, which are developing systems to support hybrid electric and fuel-cell-powered vehicles.

The race to see who can introduce an affordable hydrogen engine first is symbolized by a flurry of recent listings on London's junior exchange, the Alternative Investment Market, or AIM. But Tim Dieppe, manager of Henderson's Industries of the Future fund, said he would be hard pressed to make an investment case for the vast majority of these stocks. "How do you value loss-making companies and how can you be sure which company is likely to make that all-important breakthrough - the production of smaller and more cost-effective fuel cells?" he said.

Dieppe said he would rather explore different angles on the renewable-energy theme, like energy efficiency. His top pick is a Taiwanese company, Delta Electronics, which aims to be one of the most efficient electronics companies in the world by reducing the amount of power consumed in the production process. "As buyers of electronic equipment face increasing pressure to opt for efficient producers, companies such as Delta should prosper," Dieppe said.

Liebreich agreed that energy efficiency would grow in importance. "It may not be a headline-grabbing concept," he said, "but with oil hovering at around \$60 a barrel it makes sense for companies to spend money on making energy savings."

And even if the oil price falls back, Dieppe said, corporations are unlikely to divert their attention away from energy consumption. "The past two years have been a wake-up call for heavy energy consumers," he said.

Energy efficiency is a very fragmented area of the resources industry, but Liebreich has identified a handful of companies he thinks have decent business models and reasonable valuations. They include Itron, Power One, Capstone Turbine and Echelon.

Health

Of all the industries of the future, biotechnology has the greatest potential to enrich the greatest number of lives. The decoding of the human genome has opened the door to a new era of modern medicine. Major new drugs have been developed for the treatment of the human immunodeficiency virus, arthritis and diabetes. Innovative treatments for cancer and cardiovascular diseases are in the pipeline. All these developments are creating investment opportunities.

One of the major themes, both of research and of investment, is personalized medicine, which aims to understand the effect of genetic variations on the development and treatment of diseases. "We will not see quantum leaps in 2006 towards personalized medicine, but it will become more and more important over the coming years," said Dr. Nora Frey, founder of Adamant Biomedical Investments, a Swiss advisory and investment firm. "Companies are already using techniques to select patients more accurately for clinical trials. This should lead to fewer side-effects and better and more appropriate usage of drugs. Ultimately this will also lead to a reduction of costs for the health care systems, since drugs will only be given to patients that respond to and tolerate them."

Frey's picks included Roche and Affymetrix, the latter for its leading position in gene chips, used in research, screening and genetic profiling. She also singled out DeCode Genetics: "The company has unique access to the genetic history of the Icelandic population, which has undergone very little intermixing with other population groups," Frey said. "In addition, the family histories of the population can be traced back in history. The matching of these two data sources provides DeCode and Roche, with which DeCode has agreements, with substantial advantages for developing personalized medicines."

Companies based in emerging markets will also play a more important role in the years to come, especially in generics - unbranded, off-patent medicines - and their biotech equivalents, biogenerics. Frey said she anticipated that these drugs would achieve successful market penetration in the West in three years.

"We have found a number of companies in India, for example, that are very active not only in their fast-growing home market, but also in Europe and the U.S.," Frey said. Ranbaxy and Dr. Reddy's are most familiar, but Frey said there were "at least 10 additional companies in India that need to be watched," including Wockhardt, Strides Arcolab, Matrix Laboratories and Orchid Pharmaceuticals.

Hospital chains in emerging markets are growing rapidly as incomes rise, creating a middle class that can afford the care of a private hospital. Publicly traded companies in this field include Apollo Hospitals in India, Parkway in Singapore and Netcare in South Africa.

Gareth Powell, manager of a biotechnology fund for Framlington Group in London, said the importance of "anti-infectives" would increase in the next few years. Major players here are Gilead, Anadys, and Idenix in hepatitis and HIV, and the Swiss antibiotic companies Basilea and Arpida. Powell recently invested in Panacos, which he said was close to perfecting a new type of HIV drug. He also likes GlaxoSmithKline for its cervical cancer vaccine.

Attracted by the huge potential of biotech stocks, many managers of diversified funds have increased their holdings. Ian Henderson, an investment manager with J.P. Morgan Chase in London, said he had been following the work of Benitec, "a tiny, thoroughly speculative company" that is developing therapies to treat diseases like AIDS and certain cancers. The aim of the therapy, called RNA interference, is to shut down the genes that cause the diseases. Scientists have had success with plants and animals; now they are working on Phase 1 clinical tests for the treatment of human diseases.

Nanotechnology

A major bet on nanotechnology could be the payoff of the decade, or the stuff of investment nightmares. Nanotech refers to the engineering of matter at the subatomic level. Since particles at the nano scale do not adhere to the principles of classic physics, they can be manipulated to achieve size-dependent properties and functions.

The applications of this technology are seemingly endless. While most of the commercially viable nanotech products enhance the properties of existing materials, making them stronger, lighter or more reflective, other companies focus on the energy, water and health care markets. The technology is already being used in the development of hydrogen fuel cells, and there are products in the pipeline that could revolutionize the way drugs are delivered.

Estimates suggest that sales of products using nanotechnology could grow to \$1 trillion in 10 years, from \$13 billion now. Little wonder that comparisons between nanotechnology and the advent of information technology abound, though Heather Langsner, an analyst with Innovest Strategic Value Advisors in London, said the comparison was not perfect. "Product safety was not a concern for software," she said.

Nanoparticles demonstrate different toxicity than larger particles because of their mobility and increased reactivity. The main safety concern is that these particles might be able to cross protective membranes like the skin and the blood-brain barrier.

Innovest has reviewed about 300 companies to try to identify which show the most promise from an investment perspective, both in terms of product potential and of the company's readiness to deal with negative market sentiment. The Innovest index lists 15 companies, from diversified manufacturing and chemical companies like BASF and General Electric to more specialist companies like Altair Nanotechnologies, which is pursuing nanotech applications in the medical sector and materials market. There are also several instrument companies - like Fei, Veeco and JMAR Technologies - that develop equipment to detect and view nano particles.

Although the index is not investable, there are others that are. PowerShares Lux Nanotech Portfolio is the first exchange-traded fund based on nanotechnology companies. The portfolio is designed to track the Lux Nanotech index, which includes 26 public companies. A significant proportion of these companies also are featured on the Innovest index. Lux also includes food producers like Nestlé and Kraft, which use nanotechnology to change the structure of food and food packaging.

Matthew Nordan, vice president of Lux Research, said PowerShares was designed to appeal to investors who want exposure to nanotechnology research and development and commercialization,

primarily in small, innovative companies, but also in the large caps like 3M and GE. The index is up 13 percent since its introduction Oct. 21.

The long term will tell the tale in nanotechnology. Giulio Frisco, a scientist and member of the Future Technologies Advisory Group, which promotes awareness of scientific advances, said the next 20 years would see the first operational applications of nanotech.