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FEATURE

The Smart Way to Play the Green Revolution

By Mike Hogan March 2, 2009 11:59 pm ET

ON MAIN STREET, GREEN IS THE NEW BLACK. On Wall Street, however, most green investments generated a sea of red ink last year. When the wheels came off stock markets around the globe in the fourth quarter of 2008, alternative-energy and clean-technology shares were among the hardest hit.

The 88-stock WilderHill New Energy Global Innovation index, a popular green-industry benchmark, ended the year down 61%, versus a 38.5% slide in the Standard & Poor's 500. This year, the NEX -- a mix of mostly small- to mid-capitalization wind, solar, biofuel and energy-conservation leaders from 21 countries -- is off about 22%, lagging the S&P's 17% decline.

Washington is targeting billions for new clean-tech programs. But it's old companies with fresh ideas that will deliver the goods.
Nicholas Eveleigh for Barron's

Other clean-tech indexes, exchange-traded funds and mutual funds, including the vaunted Winslow Green Growth Fund (ticker: WGGFX), haven't fared much better, and in some cases have done worse, while venture-stage green companies have been starved of capital or blocked on their way to the public markets.

Brian Fan, senior director of research for the Cleantech Group, cites 80 green companies in the latter boat, burning through a collective $2 billion of venture-capital money with little prospect of going public any time soon. "The companies we talk to are trying to stay solvent," says Fan. Indeed, the same might be said of their financial backers, and other green-oriented investors.

A global recession and bear market deserve much of the blame for the carnage in green-tinged shares, as does a $100-a-barrel plunge in oil prices, which suddenly made the drive for sustainable-energy alternatives seem less pressing. Moreover, many clean-tech companies are small and speculative in nature, and serve end markets that depend on government subsidies -- not a particularly attractive investment attribute. Former solar-energy highfliers such as First Solar (FSLR) and LDK Solar (LDK) faced additional challenges last year from sharply escalating prices for polysilicon, the raw material used in solar cells.

In toting up the losses, it is tempting to wonder whether green-themed investing was just a sustainable version of sock puppets -- that is, another Wall Street fad. But such musings couldn't be more misguided. In the U.S., President Barack Obama has just pledged to spend billions on environmentally friendly technologies, while Congress is planning to put more money and muscle behind the search for energy alternatives and pollution controls (see "Obama's Blueprint for a Daring Green Machine").

Energy Secretary Steven Chu recently told *Barron's* sister publication, The Wall Street Journal, that his agency intends to fast-track billions of dollars in loans for alternative-energy projects already "in the pipeline," and that he will try to get roughly half the $37 billion already set aside for clean-tech capital projects distributed within the year. That is just a down payment on much more ambitious economic initiatives, and is mirrored by similar endeavors abroad.

GREATER GOVERNMENT FUNDING BODES well for some pure plays in the solar, wind, ethanol and biomass industries. But it bodes even better, near term, for well-established, diversified and financially healthy companies like Switzerland's ABB (ABB), Florida utility FPL Group (FPL), Waste Management (WMI), Jacobs Engineering (JEC) and electrical-products supplier Eaton (ETN). All are visible and increasingly powerful players in areas given spending priority: energy conservation, infrastructure renewal and the build-out of a "smarter" power grid.

To be sure, more public and private spending will benefit alternative-energy giants like General Electric (GE), the biggest U.S. supplier of wind turbines, and United Technologies (UTX), a leader in making buildings more energy-efficient. Johnson Controls (JCI), Honeywell (HON), AES (AES) and others that make sensors and systems needed to optimize HVAC (heating, ventilating and air-conditioning) also belong on any list of likely green winners.

So do a handful of midsized players in the fast-growing wind-energy-generation supply chain, such as Kaydon (KDN), a maker of ball bearings critical to wind-turbine efficiency; Woodward Governor (WGOV) a specialist in energy-generation and transmission components; MasTec (MTZ), a builder of generation and transmission facilities, and Valmont (VMI), which makes transition towers and other utility structures. "All are profitable, old-line industrials projecting double-digit growth in 2009 and trying to reinvent themselves," says Ed Mitby, an analyst at Van Eck Associates.

But we consider ABB, Waste Management, FPL, Jacobs and Eaton a sort of green dream team, for all the reasons, and then some, explained below. They probably aren't the first names that come to mind when you think "green," but they have the products, technologies and, not least, the financial strength to deliver for investors. Even better, their stocks are bargains.

A PROVIDER OF POWER AND AUTOMATION systems, ABB tops most shortlists of companies likely to benefit from large-scale energy projects and conservation initiatives. Among other things, the 125-year-old industrial giant is one of the world's biggest builders of electricity grids.

With credit frozen and demand constrained, ABB faces the same challenges as other industrial outfits. But the company, profiled favorably in *Barron's* last spring ("The GE of Europe Is a Major Power Player," May 19, 2008), is better positioned to benefit from more government and industry spending on infrastructure upgrades around the world, says Van Eck's Mitby.

Headquartered in Zurich, ABB sells large-scale electrical circuitry, robotics and energy-monitoring and automation systems. It seems to land one multimillion-dollar infrastructure contract after another, including a recent $63 million deal to upgrade a power station in Saudi Arabia. Renewable-energy projects will need ABB's products and services, and its technology, including power-management sensors and load-balancing systems, has kept it ahead of most competitors, says Morningstar analyst Daniel Holland.

ABB's shares have been cut by almost two-thirds, to 12, from their high last May, and now trade for nine times 2009 estimated earnings of $1.32 a share, a discount to the S&P 500's price/earnings multiple. Granted, last year's earnings were higher, at $1.74 a share, slightly exceeding expectations. Morningstar puts the company's fair value at 19 a share, some 62% above last week's close. Investors can collect a 46-cent annual dividend (for a current yield of 3.8%) while waiting for the global economy to jump-start.

ABB recently shed some poorly performing assets in an efficiency drive of its own. The company boasts a strong balance sheet, and net cash (cash minus debt) of $5.4 billion, or $2.40 a share, Holland notes. It has used excess cash to boost its payout and buy in shares. Twelve-month return on equity of 28.39% is more than three times that of its peer group, which includes industrial outfits such as Emerson Electric (EMR) and Danaher (DHR).

"We are in the sweet spot of energy efficiency and of climate change," chief financial officer Michel Demaré told *Barron's* last spring. For ABB, it is about to get sweeter.

AS THE NATION'S LEADING PRODUCER of energy from wind and solar power, FPL Group is at the forefront of commercialization of these technologies. The Juno Beach, Fla.-based company also is the largest power generator in one of the nation's most populated states. Its regulated utility arm, Florida Power & Light, serves 4.5 million customers and contributes just over half of revenue, which totaled $16 billion last year.

A slightly smaller, but faster-growing revenue stream flows from FPL's recently re-christened NextEra Energy Resources subsidiary. This unregulated clean-energy producer sells power throughout the U.S., using a diverse set of low-cost generation assets strategically situated around the country to balance the load. Last year, 38% of Next- Era's capacity came from wind power, which has benefited from the recent extension of production tax credits. NextEra's net income roughly tripled in 2008.

The credit crisis and weakening consumer demand have led NextEra to slow the pace of expansion in its wind-power operations, but the company "already controls a fourth of this nation's installed wind-energy capacity," notes Morningstar analyst Ryan McLean. "Nationwide, total capacity is somewhere around 25,000MW [megawatts], and NextEra has 6,375MW and growing."

WHO'S GOT THE GREEN?

Utilities and industrial conglomerates aren't the first names that come to mind in building a green portfolio. But many are fast becoming leaders in renewable energy, clean technology and smart-grid solutions, and will benefit from greater government spending. Shareholders stand to benefit, too.

COMPANY	ABB	WASTE MANAGEMENT	FPL GROUP	JACOBS ENGINEERING*	EATON
Ticker	ABB	WMI	FPL	JEC	ETN
Recent Price	$11.77	$27.39	$45.97	$34.38	$36.27
12-Month Change	-55%	-20%	-29%	-59%	-57%
Market Value (bil)	$27.3	$13.4	$18.8	$4.2	$6.0
2008 Revenue (bil)	$35	$13	$16	$11	$15
EPS 2008	$1.74	$2.22	$3.84	$3.34	$6.83
EPS 2009E	$1.32	$2.08	$4.07	$3.61	$4.10
P/E 2009E	9.0	13.2	11.3	9.5	8.8
Comments	An industrial giant, ABB is a leader in building electric grids.	The biggest U.S. trash hauler generates energy from methane gas, landfill waste.	This Florida utility also is the nation's top producer of wind and solar energy.	The construction specialist will benefit from more infra-structure spending.	Eaton's hybrid powertrains cut vehicle emissions and bolster mileage.
Other Green Winners	General Electric / GE United Technologies / UTX Emerson Electric / EMR Lockheed Martin / LMT Johnson Controls / JCI Honeywell Intl / HON	Republic Services / RSG Covanta / CVA Ameron Intl. / AMN	Duke Energy / DUK American Water / AWK Kaydon / KDN	Valmont / VMI MasTec / MTZ Aecom Tech. / ACM Fluor / FLR	Parker-Hannifin / PH Fuel Tech / FTEK Hub Group / HUBG Illinois Toolworks / ITW

*Fiscal year ends in Sept.

Source: Thomson Reuters

Wind is a relatively low-cost and profitable revenue stream for the company, which expects total profit to grow by double-digits through 2010. FPL reported adjusted earnings of $3.84 a share last year, of which Next- Era contributed $2.04. The company could $4.07 this year, and $4.54 in 2010.

Although its regulated utility has experienced reduced demand, FPL is better-positioned than most. Moreover, Florida's relatively favorable regulatory environment encourages additional investments in capacity that could boost the utility's earnings.

FPL emits less carbon than most other utilities, and will benefit from a "greenhouse gas-constrained regulatory environment," says Ken Stern, a San Diego money manager. But the company stands to profit most from national initiatives to expand wind-energy generation and bolster transmission facilities. "Transmission development had double-digit growth prospects before the credit crunch, and now, favorable legislation is coming in terms of taxes and the fast-tracking of capex [capital-spending] opportunities," says Van Eck's Mitby.

Barrons.com penned a positive piece on FPL late last year ("This Utility Will Inherit the Wind," Dec. 29, 2008), when the shares were 49.12, near the midpoint of their 52-week range. FPL recently closed around 46, and has a 4.14% dividend yield. Even a modest improvement in the economy could jolt the stock, lifting it into the mid-50s.

WITH THE LARGEST NETWORK OF landfills in the U.S., Waste Management is hip-deep in conservation and recycling programs. The Houston-based company also is a major generator of energy from methane gas, landfill waste and other recoverable waste materials.

As the nation's largest waste-disposal concern, WMI processes an eye-popping 116 million tons of garbage a year for 20 million municipal, commercial and residential customers. By its own estimate, only 6% of that goes into so-called traditional landfills, without making some contribution to green energy. Almost half of Waste Management's revenue comes from recycling and various forms of energy recovery from waste, or EfW, while traditional waste-management activities chip in the rest. Total revenue topped $13 billion in 2008.

Garbage-hauling isn't a glamorous business, but it is essential. That helps explain why the company's earnings have held up at a time when corporate profits generally are heading down a slippery slope. Waste Management earned $2.22 a share last year, flat with 2007 results, and could earn $2.08 this year. Its unmatched national network of 277 landfills gives it both pricing power and a moat against competitors, such as the industry's No. 2, Republic Services (RSG).

Waste Management generated $2.58 billion in cash from operations last year, and has found plentiful uses for its money. The company recently paid down $1.2 billion in debt, and bought back $1.4 billion of stock. It increased the dividend 7.4% in February, to an annual $1.16 a share, and yields 4.3%.

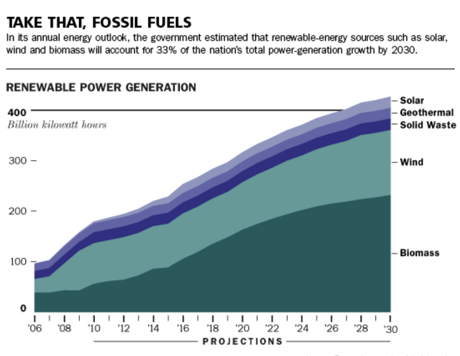
On the down side, waste volume typically contracts in recessions. The company's profitability could suffer, as well, if the price of diesel -- the drink of choice for garbage trucks -- rises, or if smaller competitors start a price war, as sometimes happen in the industry. But any setback would be an opportunity to buy stock in this century-old workhorse, which now trades around 27, or for about 13 times prospective earnings.

Morningstar pegs fair value at 33 a share. At only 80% of fair value, says analyst Bradley Meeks, Waste Management is still a "good buy."

The growing use of sustainable energy, mandated in part by the government, could give the company's earnings, and its shares, a big push. Utilities and industrial companies long have bought electricity produced by the methane gas released from Waste Management's landfills. The company's waste-to-energy incinerators, strategically placed around the country, burn about a fourth of the 30 million tons of trash incinerated in the U.S. each year. Each ton of garbage burned replaces about a ton of coal, and reduces carbon emissions significantly.

Waste Management plans to double its overall energy-generation capacity by 2020, producing enough energy to power two million homes. In February it was tapped by two Maryland counties to build an EfW plant that could meet those counties' total electricity and disposal needs. The project is expected to replace the burning of 130,000 tons of coal, and lower greenhouse-gas emissions by 500,000 tons a year. EfW is widely practiced in Europe and China, which hopes to produce 30% of its energy by such means by 2020, says Meeks.

Waste Management also recycles electronic equipment and medical waste, both growing revenue streams, and acts as a conservation consultant to non-U.S. recyclers. If there is green in garbage, the company is going to find it -- and convert it to greenbacks for shareholders.



IF AMERICA'S POWER GRID IS TO BECOME bigger and smarter, somebody will have to build it out. And somebody will have to design the project and monitor the construction. That is where Jacobs Engineering comes in. The vertically integrated Pasadena, Calif., contractor, has all of the engineering, design, architectural and other skills needed to build and manage large infrastructure projects, many that increasingly will have a green component.

Jacobs has additional expertise in managing government projects in the U.S. and overseas -- work that is sometimes more art than science, and which accounts for more than a fourth of revenue, which totaled $11 billion last year.

Revenue has increased by an average of 19% a year in the past decade. Then there is a history of beating sales and earnings forecasts by at least a few percentage points. In the quarter ended Dec. 31, the first of its fiscal year, Jacobs delivered earnings of 94 cents a share, up from the 89 cents analysts expected, on revenue that jumped 31%. Management guided full-year earnings downward slightly, to $3.55 to $3.90 a share, but if past is prologue, the final results might offer a pleasant surprise.

Not surprisingly, Jacobs also has a fortress-like balance sheet, with gobs of cash (nearly $788 million as of Dec. 31) and little long-term debt ($40 million). The company hasn't used its cash horde to pay a dividend, but may deploy it to pick up faltering rivals in markets it wants to enter, says Morningstar analyst Patricia Oey. That said, Jacobs operates in a highly competitive market, with many successful companies, including Fluor (FLR), Valmont and MasTec, above and below it on the construction and project-management food chain.

Jacobs' recent contract wins include a five-year, $17.5 million commission to manage three transportation programs in the San Francisco Bay area, and a $200 million deal to build and manage a water-reclamation project for Pima County, Ariz. That is in addition to contracts for work on oil and gas facilities, prisons, petrochemical plants and transportation systems. About 80% of its wins are from repeat customers, and 90% include cost-reimbursement, Oey notes.

Jacobs' shares hit the skids last year, losing about 60% of their value; they now trade around 34. Morningstar puts the company's fair value in the low-60s, but it may be closer to the mid-40s so long as the economy and financial markets continue to quake. Stimulus spending on infrastructure projects, transportation systems and facilities designed to use less energy more efficiently likely will help Jacobs maintain its balance, and continue delivering upbeat earnings news.

OUR FIFTH DREAM-TEAM MEMBER, Eaton, makes energy-efficient power-management systems that help reduce fossil-fuel use. Specifically, Eaton manufactures hydraulic and electric-power control systems used in automotive, industrial and aerospace applications -- and in windmills.

The company recently launched a new venture: hybrid hydraulic/electric alternatives for fleet-vehicle propulsion, including one system built with the U.S. Environmental Protection Agency (EPA). Designs vary, but basically capture energy from braking and other subsystems to augment or replace the traditional diesel engine. Particularly promising for city buses, delivery trucks and other vehicles that start and stop frequently, the EPA estimates such powertrains could produce fuel savings of 20% to 40%, and cut carbon emissions by as much as 40%.

So far, those vehicles are limited to pilot programs, but the "pilots" include big customers like United Parcel Service, Federal Express and Wal-Mart, as well as school buses used as far away Melbourne, Australia and Guangzhou, China. Eaton has many competitors, but unlike others that dream of replacing the combustion engine, it has been an automotive-technology leader since 1911.

With 2008 sales of $15.4 billion, the Cleveland-based company has the design, manufacturing and financing in place to scale its ideas. Its truck group alone sells $2.3 billion of transmission and hybrid-power and exhaust systems for trucks, buses and agricultural equipment. Eaton knows its customers, and the costs and challenges of operating in 150 different countries. But its strengths also raise concerns.

"I like Eaton, but I'm worried about its earnings [expectations] earnings being overly optimistic due to its heavy exposure to the auto industry," says Ken Stern, the San Diego investment manager.

Morningstar analyst John Kearney is more upbeat, noting an aggressive acquisition strategy has diversified the company's revenue and profits. Draconian cost-cutting measures also have helped. Eaton earned $6.83 a share in 2008. This year, management is guiding profit expectations downward to between $4.20 and $5.20 a share; the wide range reflects economic uncertainties.

Eaton has paid a dividend for 85 years, and yields 5.41%. Its current payout, $2 a share, must have been of some comfort to investors, whose shares have lost about half their value in the past year, and now trade around 36. At least one savvy holder used the opportunity to snap up more stock: Warren Buffett's Berkshire Hathaway (BRKA) upped its stake in Eaton in the fourth quarter to 3.2 million shares, from 2.9 million.

LIKE BUFFETT, WE DON'T KNOW where Eaton will trade in a month or a year, only that the products, services and ingenuity of Eaton and companies like it are making the world greener and cleaner. When the smoke -- or is it carbon? -- clears, they and their shareholders are likely to rewarded.