ACUITY FUNDS LTD

ACUITY'S *INSIGHTS*

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Covering Sustainable Investing: the Acuity Clean Environment and Social Values Mutual Funds.

Recent events in the United States have shocked and saddened the world. Discussions of matters other then the tragic losses felt directly by families in the U.S. and elsewhere continues to feel somewhat trivial. However, as we begin to take some small steps towards normalcy, inevitably our thoughts turn to what the future holds - both in terms of political and economic developments.

SUSTAINABLE INVESTING DEFINED
Based on rigorous financial analysis, sustainable investing applies additional environmental or social criteria to the selection of potential investments.

As Acuity staff have begun to hold seminars and meetings related to our mutual fund products, we have noticed a renewed interest in sustainable investing. The confusion and hesitation that many investors feel is at least partially replaced by the knowledge that one can invest for a good return, while still furthering societal values.

KEY ISSUES WITHIN SUSTAINABLE INVESTING

Energy Technologies - boom or bust? *

If recent headlines are any indication then one can assume that the energy technology or 'alternative energy' sector has gone the way of the dot-com – another burst bubble. Is the story really over just as quickly as it emerged? As long term investors in environmental sustainability, we don't think so, but the sector needs to be evaluated with appropriate rigour. Some of the key dynamics which we use to assess potential in this sector are highlighted below.

Dynamic 1: Market Opportunity
In order to attract attention to a technology, it has to address a large market. The alternative energy sector is composed of companies that are developing new cleaner sources of energy for transportation, residential or stationary power applications. These are huge markets with suitably exciting opportunity estimates. In 2000 many investors, stirred by soaring energy prices and related 'crisis' woke up to the revenue potential of companies in this sector.

However, this year has been another story with dropping fuel prices and moderate weather. Investors are now applying lower penetration rates for 'distributed generation' and related technologies and have started to seriously consider dynamics 2 through 8.

Dynamic 2: Technology Robustness
I won't spend much time on #2, suffice to say that the 'better mousetrap' needs to actually work – within normal field conditions. Some alternative energy companies launched into the public markets in order to 'cash in' while the iron was hot, and are now realizing that their technologies were not robust enough to warrant a public share float.

Dynamic 3: Time to Market
Even those companies with robust technology now realize that their path to commercialization needs to relatively quick and should be lined with clearly defined milestones. The general market tends be fairly short sighted (e.g. 12 months out) and is increasingly unforgiving when milestones are missed.

Dynamic 4: Cost Competitiveness
Development of an inherently cleaner or more efficient technology is not, in itself, enough to ensure adoption. Without cost competitiveness, even the most well-meaning public incentives can have bizarre consequences. Consider this example: state imposed requirements to convert the 10,000 strong public bus fleet in Bangladesh from diesel to cleaner burning natural gas will likely result in reduced public transit availability coverage as the higher costs force budget cuts in overall route coverage.

Expect companies that have value propositions which rely on premium 'environmental' pricing or government subsidies to be discounted by the market. Some exceptions exist but these are rare.

Dynamic 5: Manufacturing capabilities
Few technology development companies are able to translate their prototype into a design that is easily produced on a large scale. Barriers include management capabilities, capital requirements, supply chain issues, and technical challenges (in tooling a production facility). Confronted with these challenges, many early stage companies have found themselves missing targets or shopping for a buyer.

COMPANY PROFILE

Our Company Profile section highlights innovative companies held in our funds.

Canadian Tire
Canadian Tire is one of Canada's largest retailers selling automotive, sports and leisure, home products and petroleum products. The company is in the process of renovating its store network which consists of relocating, significantly expanding the store size as well as the products offered. These changes have produced a substantial increase in sales. Additionally, the company's real estate portfolio could be worth as much as $1.5 billion or over $15 per share.

Canadian Tire is a leader in terms maximizing its positive influence on its employees and community. Driven at the highest levels, through a social responsibility committee at the board of directors, policies and programs with social impacts are initiated and reviewed. Employees are offered a share purchase plan through to which the company matches 50%, or up to 10% of an employee's salary. The company has a code of business conduct, which is distributed to all employees annually for review and sign off. Canadian Tire is also active in terms of diversity, with three women directors out of 16 – a high percentage relative to Canadian businesses in general.

Dynamic 6: Management
While all alternative energy companies tend to have strong technical expertise, few have the necessary production skills to ensure a smooth market introduction. This is the old 'scientist does not a good manager make' dilemma. Many of the qualities embodied by the company's founder, can be handicaps in the ramp up for production and volume sales. Companies who recognize this weakness and bring on strong operating experience will be the most likely to succeed

Dynamic 7: Distribution strategy
In the absence of meaningful sales (in certain sectors such as Wind Power, sales are already quite strong) investors will tend to assess the 'company that they keep'. Ballard Power, for instance, has maintained a market premium partially due to the confidence with which investors hold the involvement of Ford, Daimler Chrysler, Honda, Coleman, Ebara etc. Failure to announce new strategic partnerships, or to show progress in existing ones has hurt some alternative energy companies this year.

Dynamic 8: Financing
Many energy technology companies require further financing to reach commercialization. While 2000 provided the perfect storm in which to raise energy related money, 2001 has investors worried about throwing good money after bad. Those companies that are flush with cash are clearly in a desirable position.

In Conclusion…
In the short term, expect energy technology stocks to be fueled by the fear (or lack) of increasing demand and rising energy prices. Fear is the main factor because most of the technologies are not commercial and therefore accrue no real financial benefit from short term demand/supply conditions. Over the long term take heart in this sector's primary driver – society's insatiable appetite for energy, increasingly generated in an environmentally friendly manner .The successful energy technologies will provide the bridge between these two objectives by addressing the dynamics discussed above.

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