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FEATURED COMPANY

Vermont Pure Holdings: Taking the Waters Has Never Been so Profitable

BY CHANNING PAGE

RANDOLPH, VT — At the recent designer fashion shows in New York's Bryant Park, liquid refreshment consisted of iced Evian and nothing else. On the sidewalks of Boston's Back



Bay, the young and fashionable can be seen sipping their Dasani as they dash to the next appointment. At board meetings around mahogany tables or brainstorming sessions in high tech cubicles, important discussions are washed down with water — in crystal glasses or straight from the bottle.

No longer just for quenching your thirst, water is chic. Water is cool. Water is a statement about the healthy lifestyle.

More and more Americans are turning to water as their beverage-of-choice. After decades of believing that things go better with Coke, the Pepsi generations have discovered the real Real Thing. But they aren't simply turning on the

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Water: Looming World Crisis Presents Green Investment Opportunities

BY ELLEN PFEIFER

ALTHOUGH CURRENTLY OVERSHADOWED BY THE HEADLINES FROM THE MIDDLE EAST AND THE WAR ON TERRORISM, THE NEWS ABOUT WATER IS OMINOUS. IN MASSACHUSETTS, RAINFALL SINCE LABOR DAY HAS BEEN HALF THE NORMAL AMOUNT AND RIVERS, STREAMS AND GROUNDWATER LEVELS ARE EXTREMELY LOW. IN BOURNE, MA ON CAPE COD, THREE OF THE SIX TOWN WELLS HAVE BEEN CLOSED AND A FOURTH MAY SOON FOLLOW AS THE RESULT OF



ground water contamination by perchlorate from the nearby Massachusetts Military Reservation.

Fearing that public drinking supplies are potential targets for terrorists, some municipalities have been scrambling to take preventive action. Norwood, MA, for example, is considering the reactivation of a town well to serve as a backup to supplies from the Massachusetts Water Resources Authority.

The Environmental Protection Agency reported in April that the overall condition of U.S. coastal waters is fair to poor and that 44% of estuaries are "impaired for human use or aquatic life."

In the United Kingdom, the Environmental Agency announced that oestrogens in sewage effluent are adversely affecting the reproductive ability of male fish that live in freshwater lakes and streams.

And, at a recent environmental conference in Melbourne, Australia, a researcher projected a doubling of water demand over the next 50 years — even if the world's population doesn't increase.

Summing up all the concern, UN Secretary Kofi Annan warned on World Water Day (March 22), that "fierce national competition over water resources" could result in violent

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Water Table Down, Water Stocks Up

JACKSON W. ROBINSON

If there is any positive investment news to be extrapolated from the damage inflicted by global warming and changing weather patterns, one needs look no further than the water industry. Record setting temperatures and droughts are augmenting the already rising demand for clean water. As a result, water stocks are surging.

To measure the performance of the water stocks, we created the Winslow Water Index (see table), an equally-weighted index of eight domestic water companies including two large utilities and a variety of related businesses including a small, independent bottled water firm. The latter, Vermont Pure Holdings is

featured in this issue of the *Winslow Environmental News*.

Since the "bear market" hit bottom in the wake of 9-11, U. S. water stocks have outperformed the overall stock market by a factor of three (see chart). Specifically, between September 28, 2001 and mid-April 2002, The Winslow Water Index is up +18% versus the S&P 500, which has gained a mere 5.8%.

The longer-term numbers for water stocks are also impressive. According to Debra Coy of Schwab Capital Markets, the Schwab water-stock index of 20 companies has outperformed all the major indices since it was created in 1999. Up +41% from inception, the Schwab

index also includes two French and UK water companies.

Of course, drought is not necessarily good news for all water companies, especially water utilities that are forced to curb usage due to drought restrictions. Reduced unit sales means lower revenues and profits, at least until rate increases and/or alternative sources of water are secured. Certainly, the biggest boost to water utilities would be more rain, obviously a factor that is unpredictable.

In addition to water utilities, many other industries suffer because of drought. These include lawn and garden products, tourism, farming, car washes, developers, forestry, parks, and golf courses. From an investment point of view, companies in these industries that do not have secure water resources should be avoided.

As the demand for water becomes more acute, so will the demand for water filtration, treatment, recycling, and conservation products and services. We believe that the companies occupying these niches will continue to benefit from the drought, whether it is temporary or permanent. That translates into many attractive growth opportunities. 🌱

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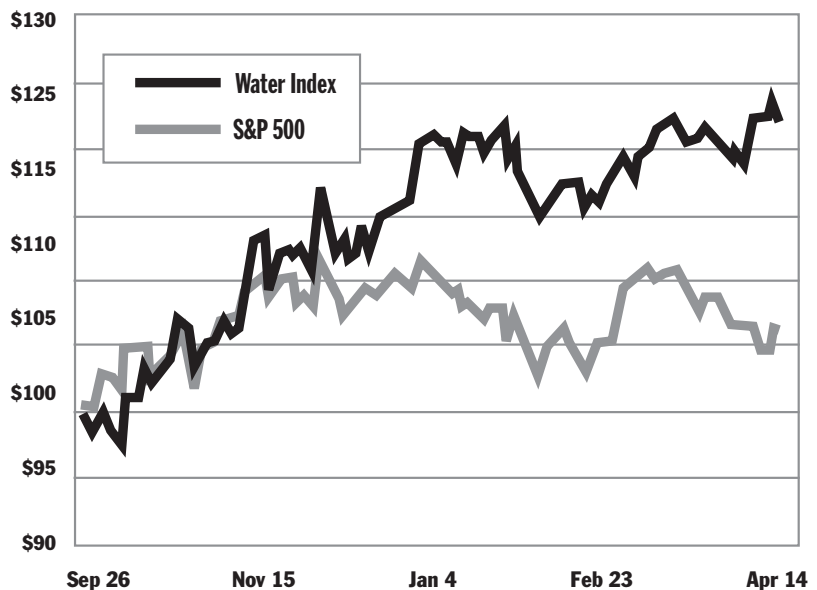
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Water Index vs. S&P 500 since 9/28/2001



Winslow Water Index

Company Name	Business Area	Market Cap
American Water Works (AWK)	Public water provider (utility)	\$4.3b
Cadiz (CLCI)	Water development and agricultural resources company	\$320.8m
Cuno (CUNO)	Designs, manufactures and markets filtration products for the separation, clarification, and purification of liquids and gases	\$585.9m
Insituform (INSUA)	Trenchless technology for the rehabilitation of sewer, water, gas, and industrial pipes	\$686.4m
Ionic (ION)	Manufacturer of desalination plants and equipment	\$557m
Philadelphia Suburban (PSC)	Public water provider (utility)	\$1.3b
Vermont Pure (VPS)	Bottled water company	\$105.4m
Watts Industries (WTS)	Designs, manufactures, and sells valves and other products for the water quality, water safety, water flow control, and water conservation markets	\$426.3m

but its current size and reach are the result of a strategy of acquisition and consolidation. Having purchased or merged with other water companies, Vermont Pure now carries multiple brands: Vermont Pure, Iceberg Springs, Crystal Rock, and Hidden Spring.

Two Varieties, Two Markets

Despite the different names, the product line breaks down into two basic types of water: spring and filtered. Under labels including Vermont Pure Springs and Hidden Spring, the company sells spring water pumped from its properties in Randolph and Tinmouth, VT, as well as from a third-party property in Stockbridge, VT where it holds a 50-year contract. Permits regulated by Vermont law would allow the company to withdraw as much as 400 million gallons annually, but its current demand is projected to be only 4 million gallons.

Crystal Rock, the subsidiary that merged with Vermont Pure in October 2000, purifies and re-mineralizes ordinary tap water. It distributes the water in two, three and five gallon re-usable bottles to homes and offices. With a manufacturing plant located in Watertown, Connecticut, it can efficiently serve its primary customers in Connecticut and New York. But because it uses regular tap water, Crystal Rock could expand anywhere.

For both sources, Vermont Pure's bottled water reaches the consumer through two mechanisms. Single-serve bottles made of polyethylene terephthalate plastic (PET) are sold in retail establishments to individual customers. The larger jugs are delivered directly to individual and corporate clients. The former segment is growing faster, but it provides a lower profit margin. In the first quarter of 2002, Vermont Pure enjoyed a 22% increase in retail PET sales over the same quarter in 2001, and netted a 5% margin before taxes. By contrast, its Home and Office sales saw only a 3% increase, but achieved a 19% net margin before taxes. (Total sales of all products in this

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tap. Instead they are reaching for those green or blue or ergonomically designed clear bottles containing their favorite brand, whether sparkling or still. They are gathering around the newly re-invented water cooler. And the soft drink companies have been quick to shape and exploit the trend. Indeed, the American bottled water market is the fastest growing segment of the beverage industry, having surged to a compounded annual increase of 10% over the past five years.

Vermont Pure: the one Pure Play

The brand names of the mass marketed waters evoke an image of remote bubbling

springs, deep in the forest or the mountains, gushing a pellucid, icy cold elixir. Some of these brands may, indeed, have started as small, regional companies that bottled local spring waters. But, today, bestsellers like Poland Spring, Evian, and Aquafina are the products of the standard retail giants Perrier, the Danone Group, and Pepsi. There is only one publicly traded company that focuses exclusively on bottled water and offers investors a pure-play in this fast growing industry. That company is

Vermont Pure Holdings (AMEX:VPS).

Headquartered in Randolph, VT, Vermont Pure started in 1990 as a small, local company,

The company is poised for growth as part of an expanding industry. Many experts believe Vermont Pure will be acquired by one of the large retail companies. This scenario becomes more persuasive as companies find it increasingly difficult to secure sources of spring water.

Justice. Beginning with a raid on company offices last August, the Justice Department has been looking into possible illegal business practices at the company's Liberty Medical Supply and Liberty Home Pharmacy units.

On the day the SEC findings were announced, the company's stock price soared 50%. It closed at \$38.90, up \$13.48, on volume of 5.18 million shares, far ahead of average daily volume of 199,200. Early in the day, the shares rose as high as \$40.33 -- a level not seen since July 31. On Dec. 5, when PolyMedica acknowledged the launch of the formal inquiry, the stock had plunged to an intra-day low of \$18.96.

Conceptus (NASDAQ: CPTS)



SAN CARLOS, CA — In an upbeat conference call on April 11, three physicians (including two clinical investigators) and one distributor reported enthusiastically on Conceptus's Essure device and the worldwide demand for permanent birth control through sterilization. The overarching theme from each speaker was the high rate of satisfaction among women participating in clinical trials and the early roll-out. Since the procedure requires only local anesthesia, if any, patients remain awake and able to engage in dialogue with the physician. One of the speakers referred to it as "operating with the woman, not on the woman".

After the call, which was hosted by Adams, Harkness & Hill, analysts felt confident that the Essure device will become a standard of care in the permanent sterilization of women. Although specifics on the Phase III clinical trials were not provided, Dr. Jay Cooper, the trial's principal investigator, gave the device and procedure top marks. Analysts reiterated their Strong Buy rating and the CY02 year-end price target of \$27 per share. Analysts are also optimistic that CPTS will be on the agenda at the July (or possibly October) FDA panel meeting which could lead to a Q4'02/Q1'03 FDA approval.

international conflict. "A looming crisis that overshadows nearly two thirds of the Earth's population is drawing closer," he said, "because of continued human mismanagement of water, population growth and changing weather patterns."

Limited Supply, Poor Stewardship

Underlying these new stories are several stark facts: there is a finite supply of water, ever-increasing demand, and too much waste or pollution.

Although three-quarters of the Earth's surface is covered with water, only 3% is fresh and two-thirds of that is ice. Less than 1% is potable (safe to drink). Already 48% of the world's population lacks access to drinking water, reports the Library of Congress's Federal Research Division. According to UNESCO figures, the demand for water in the 20th Century increased six fold, more than double the rate of growth in the human population. Much of this increase was due to the dramatic expansion of irrigated land (agriculture now accounts for 70% of total water use).

At the same time, pollution in many regions further reduced the supply of water--sometimes with lethal consequences. For example, in India and Bangladesh, arsenic concentrations in potable water supplies are so high that millions of people are at risk of arsenic poisoning.

"Water pollution, poor sanitation and water shortages will kill over 12 million people this year," says Klaus Toepfer, of the United Nations Environment Programme.

Market Trends Driving Water Industry

In developed nations, at least, water has so far remained relatively cheap and readily available. However, the marketplace will undoubtedly begin to feel the impact of the increased pressures on water supply. And, as the multi-faceted water industry devises solutions to the problems, there may be significant opportunities for ecologically minded investors. According to Winslow analyst Namrita Kapur, these are some of the trends likely to shape the industry:

- Growing demand
- Increased public concern about the purity of

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segment actually increased by 9%, but the gain was offset by a 9% decline in the sale of associated coffee services.)


A Pricey Acquisition

The merger of Vermont Pure and Crystal Rock was driven by the opportunity to expand the product line, to consolidate delivery routes, and combine back-office services. This coordination of internal operations has taken longer than originally expected, but is expected to drive cost savings in FY 2002 so that sales growth of 10-12% will be eclipsed by EBITDA growth of 15-20%.

However, these savings will come at a cost. In particular, the merger has added to Vermont Pure's debt load. Certainly a strong cash flow will enable the company to pay down its debt

schedule aggressively, but the current long-term debt-to-capital ratio of 52% will preclude any additional acquisitions in the near future.

Things Go Better with Vermont Pure?

Nonetheless, the company is poised for growth as part of an expanding industry. Many experts believe Vermont Pure will be acquired by one of the large retail companies. This scenario becomes more persuasive as companies find it increasingly difficult to secure sources of spring water. However, Howard Halpern of Taglich Brothers argues that Vermont Pure must reach a critical size of \$100 million in revenue before a corporation of Coca Cola's magnitude would consider such a step. And at a current level of \$75 million in sales (as projected for 2002), it may take Vermont Pure three or more years to reach that point. 

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municipal water due to fears of contamination and terrorism.

- Rising water prices as the result of conservation mandates, population expansion in arid regions, and regulation of water quality standards.
- Decay of aging infrastructure that will require approximately \$2 trillion over the next 20 years in upgrades.
- Consolidation of design, engineering, operation, maintenance and treatment operations within large multi-national firms.
- Changing ownership structure due to corporate mergers and expansion of utilities' services.
- Increased privatization and outsourcing of water and wastewater plant operations in both the governmental and industrial sectors.
- Increased federal funding—including \$823 million in 2001 for clean water and \$2.1 billion for wastewater treatment plus \$90.3 million newly targeted for counter-terrorism initiatives.

A Huge Market with Segments for Everyone

As of 1999, the water quality systems market in the US was approximately \$86 billion. The largest segment is public wastewater (sewage systems) at 35% of the market or around \$30 billion. Public water supply accounts for 34% or \$29 billion (\$24 billion accrues to municipalities and \$5 billion to investor-owned regulated water utilities). Construction accounts for 11% of the market or about \$9 billion. Services involve laying sewer pipe and pouring concrete. Equipment com-

prises 6% or about \$5 billion and includes pumps, valves, meters, control and treatment systems. Treatment chemicals, bottled water, and point-of-use/point of entry systems each account for 4% of the market or about \$3 billion. Contract operation and maintenance of both municipal and industrial water and wastewater treatment plants comprise the remaining 2% or less than \$2 billion.

Of the total, private sector firms control only 31% of the market while regulated utilities make up 6% and municipalities comprise 63%.

A Wide Range of Water Companies

Broadly speaking, there are three advisable ways to invest in water

industry stocks, according to analyst Kapur:

- Water suppliers, that is, investor-owned utilities. The two biggest are American Water Works (AWK) and Philadelphia Suburban (PSC).
- Companies that provide the technology for potable and ultra pure water. Ionics (ION) is the important player but smaller companies with good potential include Trojan Technologies (TUV.TO), Zenon Environmental (ZEN) and Cuno Inc (CUNO).
- Small companies that have a distinct competitive advantage, a unique technology, or broad distribution that make them likely candidates for acquisition. Insituform (INSUA) has a patented process for "cured-in-place pipeline rehabilitation". Watts Industries (WTS) is a leading manufacturer of valves. Vermont Pure Holdings (VPS) is the only pure play available in the bottled water industry and is the eighth largest US company in the segment (see

Already 48% of the world's population lacks access to drinking water, [and] the demand for water in the 20th Century increased six fold, more than double the rate of growth in the human population.



AH&H Summer Seminar

From August 6-8, Adams, Harkness & Hill is hosting its annual Summer Seminar at the Marriott Long Wharf Hotel in Boston, featuring preeminent companies in the emerging growth market. Following are some of the environmentally effective companies currently in the Winslow Portfolio which will make presentations at this event:

**AstroPower
Conceptus
Direct Focus, Inc.
Forrester Research
Gaiam, Inc.
KANA
MRO Software
NPS Pharmaceuticals
Oak Technology
OSI Pharmaceuticals
Power Integrations, Inc.**

The list of participating companies grows daily. For a current list of companies, and for information about attending the conference yourself, visit the conference website at

<http://events.ahh.com>

accompanying article).

Finally, for one-stop shoppers, there is the 900-pound gorilla of the industry—Vivendi Environnement (VE). It comprises Vivendi Water, a waste treatment company, plus several acquisitions including US Filter, Culligan, Everpure and Plymouth Products. From industrial cleanup to residential purification equipment to filters and bottled water, Vivendi covers the waterfront. 🐼

PORTFOLIO UPDATE

IMPCO/Quantum Technologies

(NASDAQ: IMCO)

CERRITOS, CA — On April 2, IMPCO/Quantum Technologies announced the signing of a multi-year agreement with Hyundai for the development and commercialization of advanced power systems for fuel cell and alternative fuel vehicles. This partnership provides the soon to be spun-off Quantum with high-profile development work and has the potential for significant near-term revenue opportunities.

In the past, Quantum has worked with Hyundai developing systems for the Santa Fe hydrogen fuel cell sport utility vehicle (SUV) and the compressed natural gas Elantra super ultra-low emissions vehicle (SULEV). Hyundai produces over 100,000 alternative fuel vehicles annually, primarily taxi cabs for the Korean market, the second largest market for liquid petroleum gas (LPG) vehicles.

In related developments, planners for the Department of Energy's (DOE) National Hydrogen Vision and Roadmap initiative met recently in Washington, DC to discuss a timetable for hydrogen development. The DOE project is a direct response to recommendations made in President Bush's National Energy Policy. Discussion at the workshop focused on current barriers to hydrogen development as well as top priority milestones for the near, mid, and long term. Fuel cell-related stocks like IMPCO/Quantum Technologies will almost certainly attract enhanced public, media, and investor attention as the DOE's work comes to fruition.

These stocks could see significant benefit from increased government funding.

Vitex, Inc. (NASDAQ: VITX)

WATERTOWN, MA — In mid April, Vitex announced that its INACTINE technology is capable of eradicating the malaria-causing *P. falciparum* parasite from blood. The technology uses nucleic acid chemistry to inactivate blood-borne viruses, parasites, lymphocytes, and bacteria. It could prevent the loss of the approximately 50,000 blood donations that are discarded each year because of malaria risk.

Vitex's clinical findings provide another example of the breadth of pathogen kill offered by the technology. INACTINE has now demonstrated that it can kill three key parasites: *P. falciparum* (malaria), *Babesia microti* infections, and *T. cruzi*, (associated with Chagas disease). The development lends further credence to the company's claims before the FDA.

The INACTINE system can also remove prion proteins from red blood cells, which in their pathogenic form cause Mad Cow Disease (or, in humans, Creutzfeldt-Jakob Disease). What's more, Vitex has a second, very promising research program underway using aptamer technology to selectively remove prions from complex solutions or to test for pathogenic prions in blood. Analysts are optimistic that Phase III approval of INACTINE will come in the near future.

MRO Software (NASDAQ: MROI)

BEDFORD, MA — In late March, MRO Software pre-announced its Q2'02 results,

estimating a loss of \$0.08 to \$0.15 per share on revenues of \$37M to \$39M. The company predicted license revenues of between \$6M and \$8M, well short of some analysts' estimates of \$15.5M. Most of the shortfall came in the higher margin license revenue, and was exacerbated by delayed purchasing, re-evaluation of the MAXIMO 5.0 Web solution, and a sluggish economy. As a result, management is lowering FY02 expectations to its original guidance of \$0.15 to \$0.25 EPS, after posting a strong Q1'02.

Customers considering the company's 4.11 solution for large deployments decided to wait and check out the newer MAXIMO 5.0 model. Their postponed purchase orders were worth nearly \$1M. Analysts expect the delay to spill over into the June quarter, particularly because sales of a typical enterprise asset maintenance (EAM) system generally take 9-12 months to close. As the transition from MAXIMO 4.11 to 5.0 progresses, any delays due to evaluations are now expected to be less severe. Sales cycles should shorten and company visibility should improve. Coupled with a recovering economy, this could positively impact the company's business.

Polymedica (NASDAQ: PLMD)

WOBURN, MA — On April 8, Polymedica, the No.1 maker of diabetes test kits, announced that the SEC had ended a staff investigation and recommended no action be taken against the company. The SEC had launched a formal inquiry in December and ordered a freeze on the trading of company shares. The commission reportedly examined the company's accounts, financial reports, public disclosures, and sale of securities.

Polymedica is still the subject of an ongoing investigation by the Department of

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