Ruminations of
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Dive Head First, or Do We Just Stick Our Toe In?

The truly tragic debacle unfolding at the BP deepwater oil well in the Gulf of Mexico has put alternative, renewable energy sources front and center. Interestingly, the impetus for the increased attention in this case is not so much economic as it is environmental. The situation has all the components to absolutely devastate an area whose size and boundaries have yet to be determined. The ultimate impact on this area is unknown at this point, but it is clearly unprecedented in scope. No resolution is in sight, and oil continues to hemorrhage into the Gulf. As the situation worsens, as it almost certainly will, the Obama administration might find itself in the position of enjoying a groundswell of support for the development of clean, renewable energy sources.

Advocates and producers of alternate energy are hoisting their banners, and the usual suspects are there — wind, solar, hydrogen, and so on. But a solution that doesn’t get the attention of these sources was one of the subjects discussed a conference in Ireland this May: ocean wave energy.

Aiming to put Ireland at the hub of ocean innovation, the SMARTOCEAN Innovation Strategy seeks to bring together a cluster of expertise, involving government bodies, universities, multinationals and small to medium sized enterprises there.

At the Galway workshop, Professor John Delaney, an oceanographer at the University of Washington, told attendees that ocean exploration was on the threshold of a new era. “About 3,000 plus years ago, we began using ships to cross the ocean and study the ocean; in 1957 the second major tool was added, the satellite,” he said. “Now for the first time ever, humans are on the threshold of entering the oceans comprehensively, volumetrically and interactively.” The Contrary Investor is not quite sure he completely understands this elegant turn of a phrase, but evidence is growing that real money is ready to flow toward efficient production of energy from ocean waves.

The earnings potential in ocean innovation became clearer during the Galway workshop when major Swedish electricity and energy supplier Vattenfall (the Swedish word for waterfall), announced plans to invest €20 billion in wave technology in the coming years, split between Ireland and Scotland. Ireland, where at least half the funds will be invested, was chosen because it has the highest wave energy resource in Europe.

Waves are caused by the wind blowing over the surface of the ocean. In many areas of the world, the wind blows with enough consistency and force to provide continuous waves, and there is tremendous energy in the ocean waves. Wave power devices extract energy directly from the surface motion of ocean waves or from pressure fluctuations below the surface.

Wave power varies considerably in different parts of the world, and wave energy can't be harnessed effectively everywhere. Wave power rich areas of the world include the western coasts of Scotland, northern Canada, southern Africa, Australia, and the northwestern coasts of the United States.

A variety of technologies have been proposed to capture the energy from waves. Some of the more promising designs are undergoing demonstration testing on a commercial scale now. They differ in their orientation to the waves with which they are interacting and in the manner in which they convert the energy of the waves into other energy forms, usually electricity.

Underwater Electricity Generation Turbines

The first known patent to utilize energy from ocean waves dates back to 1799 and was filed in Paris by a Monsieur Girard and his son. The world's first commercial wave farm is based in Portugal, at the Aguçadoura Wave Park.

Necessarily designed to operate in an inherently harsh environment, today's technologies remain largely unproven and — unless subsidized by governments — expensive. (Portugal is heavily subsidizing the Aguçadoura project, with an eye to becoming a major European exporter of clean green power in the future.) Little is known about the effects that large wave or tide farms might have on marine ecosystems in general over the longer term.

Despite the uncertainties, however, proponents say the potential advantages are too striking to ignore. Eight hundred times denser than air, moving water packs a huge energy wallop. Like solar and wind, power from moving seas is free and clean. But sea power is more predictable than either wind or solar. Waves begin forming thousands of miles from coastlines and days in advance; tides rise and fall as dependably as the cycles of the moon. That predictability makes it easier to match supply with demand.

Within a decade some experts believe the US could realistically meet as much as 10 percent of its electricity needs from so-called "hydrodynamic power." For some nations, wave and tide power could pack an even bigger punch. Estimates suggest, for instance, that the choppy seas surrounding the United Kingdom could deliver as much as 25 percent of its electricity. As a point of reference, 10 percent is about half of the electricity the US produces with nuclear power today. Although initial sea-powered generation projects are going to be expensive, as experience grows and economies of manufacturing scale kick in, hydrodynamic power will follow the same path toward falling costs and improving technologies as other alternatives.

The energy potential from the seas is enormous: worldwide, it is estimated to be at least 1,100 GW, which corresponds to the output of some 1,000 nuclear power stations. The World Energy Council is convinced that approximately 15 percent of the global energy demand can be satisfied through the utilization of ocean power resources (waves, tides, ocean currents).

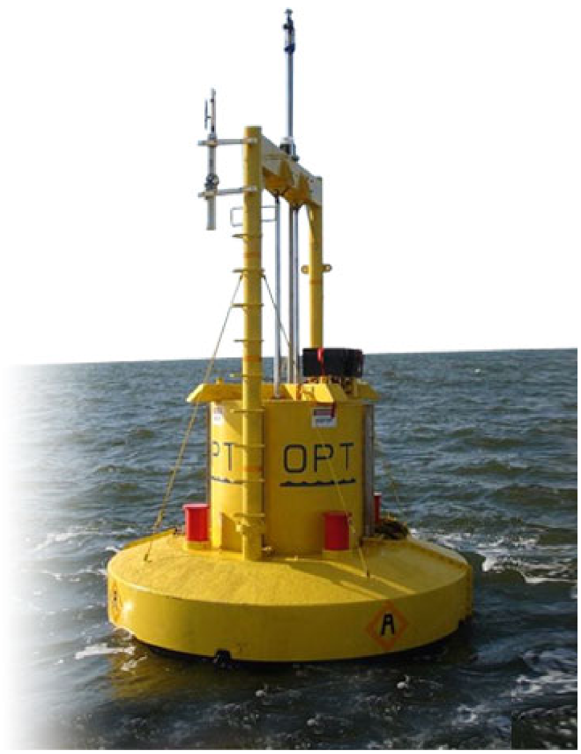
Look at wind. A kilowatt hour from wind cost fifty cents in the 1980s. Now it's about seven cents. That's about the same as producing electricity with natural gas, and only about three cents more than coal, the cheapest — and dirtiest — US energy choice. Any future tax on carbon emissions could narrow that gap even more, as would additional clean-power subsidies. Ocean-generated power will more than likely follow this same course as it develops.

Investment opportunities in this space are essentially as nascent as the technology itself, but still available for those interested. And the participants range from huge multi-nationals like Siemens to micro-cap companies including Ocean Power Technologies (NASDAQ: OPTT).

OPT is developing the first commercial wave park on the West Coast of the United States located 2.5 miles offshore near Reedsport, Oregon. The wave park will consist of ten PowerBuoys, an undersea substation to collect the power, and a submarine cable to deliver the renewable power to the Pacific Northwest electric grid. Each PB150 PowerBuoy has a maximum sustained generating capacity of 150 kiloWatts.

The estimated amount of electricity this project will deliver to the grid is approximately 4,140 MegaWatt-hours/year based on the wave resource at this location, or enough for up to 375 homes. Electricity generated by OPT's clean, renewable PowerBuoy system will displace 2,110 tons of carbon dioxide annually.

Before you go rushing out to catch this wave, the cost to get this project up and running (shouldered by Oregon taxpayers and a host of subsidies) is estimated at $60 million, or about $160,000 per house. That is as good a snapshot as any as to where this technology stands today. But the US



Navy is backing OPT with installations in Hawaii, and other projects are coming onstream. From a demographic standpoint, the vast majority of the population in the US — indeed, the world — lives near shorelines, and wave energy is close to those same shorelines.

The fact is that wave energy holds tremendous potential. In time it has the potential to compete with other renewable energy resources which, by the way, were also very expensive in their early development stages. The learning curve is expensive now but with experience, experimentation and lessons learned we will all benefit from it.

Perhaps the last word should go to the aforementioned Professor John Delaney, who emphasized the challenges of working in a marine environment. He noted that people often tell him they've been to the beach, they surf, or they love the ocean. "That is a little bit like saying the 'other day I saw the edge of a razor blade and I'm just fascinated by the steel industry'." The complexity of the oceans means there's a myriad of technological challenges to be weighed up, and the opportunities are now emerging for companies with the right strengths to dive in.

For many years, clean, green alternate energy sources have been getting lip service, and we are by no means thinking our fossil fuel-based energy infrastructure is going away any time soon. But unfortunately, the Contrary Investor believes that the damage we are about to experience from one gargantuan screwup in the Gulf of Mexico will perhaps tilt our efforts and usher in a wave of investments in alternatives.

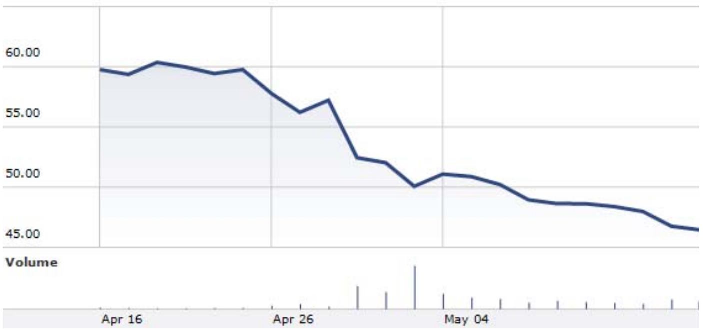
❑ Alex Seagle

Where Does This Go On a Balance Sheet?

While we are on the subject of the ongoing environmental crisis taking place in the Gulf of Mexico, we are reminded of how some issues, not traditionally present in a company's balance sheet or income statement, can adversely impact your investment portfolio.

Readers know that the Contrary Investor has been keenly interested in the impact on stock prices of companies that actively, genuinely implement policies and procedures that address ESG issues. ESG refers to an analytical framework for tracking and reporting on corporate environmental, social and governance performance and risk, and looks at the following areas: community, customers, corporate governance, employees, environment and human rights. The three factors — environmental, social and governance — are now seen as reflections of corporate risk, rather than merely a moral or ethical issue. Simply put, corporations that recognize these issues as risk components are more sustainable in the long term.

For evidence of the folly of not recognizing non-traditional risk, look at BP flailing about in the Gulf. Since the explosion on April 20, the market value of BP's stock has been trimmed by about $200 billion.



Leaking Oil: BP Stock Price Since the Explosion

And this is before anyone has *any idea* of the ultimate costs the company will absorb. BP may have the cash resources and funding options to cover the costs to stop the oil leak, contain the oil spill, and repair damaged Gulf Coast shorelines. However, it may take years for BP to resolve regulatory and legal issues – and, more importantly, to rebuild its reputation.

BP certainly understood that crude oil production is a dangerous business, but the issue is how they crafted and implemented policies and procedures to address and mitigate these risks. Said another way, BP was (granted, in retrospect) penny wise and pound foolish. Companies that take their role and duty as a corporate citizen seriously, particularly from the standpoint of ESG issues may, in the short run, appear to be wasting money. But the history of share prices for companies that consistently endeavor to innovate and improve in these areas tells a different story. These are the companies that are outperforming, and their forward-thinking bodes well for their future.

Information on companies' ESG policies is becoming more readily available. Many companies are now routinely disseminating Corporate Sustainability Reports, or CSRs that have a wealth of information focused on ESG. Independent research is available from firms like IW Financial (www.iwfinancial.com).

Risk comes in many forms, and many risks cannot be adequately addressed and identified by the study of traditional financial statements. Investors who ignore emerging ways of looking at the entirety of the companies whose stocks they buy are increasingly missing crucial information.

As evidence, two of the best-performing stocks in the Contrary Investor's portfolio — Green Mountain Coffee Roasters (NASDAQ: GMCR) and Whole Foods Market (NASDAQ: WFMI) are among the most-dedicated in their efforts to address ESG issues. I realize it is probably not fair to compare big oil to a coffee company or an organic grocer, but who said investing was fair?

- Alex Seagle

Back to the Basics

The world has seemingly become an unstable, frightening place. The European debt crisis; tensions on the Korean peninsula; oil gushing into the Gulf of Mexico...and there are many more reasons to worry. Investors and economists can extrapolate and prognosticate, and most certainly they will. The Contrary Investor believes that it is absolutely imperative — especially during unsettling times — to have a philosophy that is disciplined and deeply rooted in contrarian thinking.

To this end, we are beginning a series of articles that highlight the thinking of seminal contrarian investors. Some articles will reflect the timelessness and timeliness of contrarian thinking, and others will share the current views of these pioneers. We believe it appropriate to begin with some thoughts our founder, James Fraser, put down over ten years ago:

"After decades of work on the Theory of Contrary Opinion, the contrary approach has been so well accepted – and so loosely used – that many readers may legitimately wonder what Contrary Opinion Theory really is. Briefly put, Contrary Opinion Theory requires self-thinking.

For over 45 years Humphrey Neill and I have been hammering away at the idea that the opposite, or contrary, approach to questions and problems is a logical method of thinking. It is logical because: (a) People as a rule think very little. They do not look at the contrary side of public questions and problems concerning business and finance. (b) Majority opinion is so frequently wrong. As we like to say: When everybody thinks alike, everyone is likely to be wrong. (c) By contrast, looking at both sides of all questions, instead of being frozen by the fad of the moment, tends to lead to sounder and more profitable conclusions.

How can investors use Contrary Opinion while facing the crises and opportunities involved with real life investing? First, the investor needs to realize that generally accepted opinion may be based on false assumptions or may not be thought out to a logical conclusion, and therefore invites a contrary view. Further, it is important to be contrary to words and opinions, not to facts. Words mislead, distort, and delude. Second, avoid thinking and acting in a conventional manner. Conventional wisdom is not the way to make a portfolio grow or maximize returns.

A few further guidelines to the "uncertain art" of economic prophecy follow:

1. Much forecasting literature, both on the economy and the stock market, distills what others say – it is better to be wrong in good company than to be right by oneself.
2. Forecasting techniques are fallible. They are subject to human error, both at the forecaster's end and at the statistical end. Business is people. To forecast business you must predict human beings. But our behavior patterns are restless and dynamic, and emotions often make for strange statistical measurements.
3. The future is not always a continuation of the past. Be skeptical of past trends being stretched far beyond the present. The elastic may break or snap back when least expected.

If you can recognize that consensus hopes or fears are embodied in current valuation levels, then the realization of expectations results in no meaningful change. It is the realization of unexpected outcomes that moves prices."

When a true contrarian buys — even though every indication says "buy" — he is still scared. Contrarian investing is about emotion. The contrarian overcomes his emotion and plays on the emotion (fear or greed) of the crowd by taking a position perceived as radical. We look forward to sharing more from contrarian thinkers and investors in the months to come.

❑ Alex Seagle

Words to Consider

The first step in the risk management process is to acknowledge the reality of risk. Denial is a common tactic that substitutes deliberate ignorance for thoughtful planning.

~ Charles Tremper

There is nothing wrong with change, if it is in the right direction.

~ Winston Churchill

Society exists only as a mental concept; in the real world there are only individuals.

~ Oscar Wilde

It is the mark of an educated mind to be able to entertain a thought without accepting it.

~ Aristotle

The fact that an opinion has been widely held is no evidence whatever that it is not utterly absurd; indeed, in view of the silliness of the majority of mankind, a wide-spread belief is more likely to be foolish than sensible.

~ Bertrand Russell

Innovation distinguishes between a leader and a follower.

~ Steve Jobs

Everything, in retrospect, is obvious. But if everything were obvious, authors of histories of financial folly would be rich.

~ Michael Lewis

They would not be smart enough to pour piss out of their boots, if the instructions were written on the sole.

~ Garrison Keillor

"2-in-1" is a bullshit term, because 1 is not big enough to hold 2. That's why 2 was created.

~ Mitch Hedberg

Women marry men hoping they will change. Men marry women hoping they will not. So each is inevitably disappointed.

~ Albert Einstein

Fear less, hope more; eat less, chew more; whine less, breathe more; talk less, say more; love more, and all good things will be yours.

~ Swedish Proverb

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