

Investing in sustainable companies

Look for out-of-favor equities selling at a discount due to temporary factors



By Joshua D. Strauss
February 1, 2009

Some investors mistakenly think that sustainable investing and competitive returns are mutually exclusive. We have strong evidence that the opposite is true. For example, the Domini 400 Social Index, which measures the performance of sustainable companies, has outperformed the Standard & Poor's 500 stock Index since its inception.

These companies have historically outperformed the market because they tend to approach their business with a long-term view, treat their customers, employees and shareholders with respect, and consider the environment as a vital stakeholder. However, as with any successful investing approach, sustainable investing requires strict investment discipline to ensure success. For optimal investment results, we suggest looking for value and sustainability. To find value, we look for out-of-favor and under-followed companies whose shares are discounted heavily due to temporary factors. In today's market, forced selling has created many opportunities to buy sustainable companies at a significant discount.

The definition of what constitutes a sustainable investment might vary, depending on the investor.

When selecting stocks for The Appleseed Fund (APPLX) from Chicago-based Pekin Singer Strauss Asset Management, we review a blend of positive and negative factors, as well as qualitative and quantitative criteria, before investing. For example, we exclude companies that make certain harmful products such as cigarettes, we measure each company's environmental performance and we avoid companies that operate in countries such as Myanmar and Sudan that have significant human rights violations. We also look for companies offering products and services that promote better health, improve the economic well-being of impoverished populations and reduce their environmental impact.

We suggest investing in sustainable companies with strong balance sheets that can increase earnings within a weak economic environment. Here are four examples:

- John B. Sanfilippo & Son Inc. (JBSS) of Elgin, Ill., owner of the Fisher Nuts brand and the largest U.S. private-label nut producer, is one of our favorite investments. From a sustainability perspective, the company represents a good holding due to the products it makes. Nuts are a high-quality source of vegetarian protein and researchers have found that people who eat nuts have lower risks of heart disease. From a financial perspective, the company just moved its operations into a more efficient manufacturing facility and we think that gross margins could double, compared with fiscal year 2006 levels. The company is also trading at a price well below tangible book value and markedly below our estimate of liquidation value. We are forecasting that the company should generate >\$2.50 per share in free cash flow in FY 09, and the stock is trading around \$5. Put simply, John B. Sanfilippo meets our criteria for sustainability *and* for value.
- Avon Products Inc. (AVP) of New York offers tremendous investment value to investors. While its business is declining domestically, Avon maintains an attractive growth profile internationally, particularly in emerging markets. Except for the most dire economic environments, women will continue to use cosmetic products. The stock has fallen considerably, though Avon has done well during past recessions. On the sustainability side, Avon maintains proactive workplace practices for women and minorities.
- Annaly Capital Management Inc. (NLY) of New York is a real estate investment trust that invests in agency mortgage-backed securities. In this recession, foreclosures are an important social issue because of the detrimental impact that foreclosures and falling home prices have on local communities. An investment in agency mortgages through Annaly contributes to lower mortgage interest rates for homeowners, which will reduce foreclosure rates. From a value perspective, Annaly's earnings increase significantly when its cost of borrowing declines. Given the Federal Reserve Board's nearly zero interest rate policy, Annaly's borrowing costs are at rock-bottom level; ; as a result, the company is generating healthy net interest income. As an REIT, Annaly pays virtually all of its income to shareholders; the company's dividend yield is currently 13% today..
- Dell Inc. (DELL) of Round Rock, Texas, maintains the goal of becoming "the greenest technology company on the planet." Its recycling policy is innovative: Dell pays all shipping costs for any computers that are sent to it to be recycled. From a valuation viewpoint, Dell maintains a pristine balance sheet with \$3.32 a share in cash, and its free cash flow yield exceeds 10%. Its cash conversion cycle is negative, which means that customers pay Dell before the organization purchases the components it uses to manufacture computers.

These are just four examples of how a sustainable investing philosophy can dovetail with a cogent investment strategy. The bottom line of sustainable investing is exactly that: an investment strategy that combines a value-based orientation with a sustainability-based orientation. This combination should be able to generate strong long-term returns for the patient investor.

Author Joshua D. Strauss, CFA is a portfolio manager and shareholder of the Appleseed Fund (APPLX). The Appleseed Fund is a no-load mutual fund that seeks to generate market-beating returns by investing in sustainable, undervalued companies. In 2008, the Appleseed Fund was ranked by Lipper as the top performing mid-cap value fund and was ranked by Morningstar as the top performing sustainable fund.

You should carefully consider the investment objectives, potential risks, management fees, and charges and expenses of the Fund before investing. The Fund's prospectus contains this and other information about the Fund, and should be read carefully before investing. You may obtain a current copy of the Fund's prospectus by calling 1-800-470-1029. Past performance is no guarantee of future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Distributed by Unified Financial Securities, Inc., 2960 North Meridian Street, Suite 300, Indianapolis, IN 46208. (Member FINRA)