North Sky CAPITAL

Second Quarter 2012

MARKET UPDATE

Keep Your Head Up and Stick on the Ice

The Stanley Cup recently wrapped up, so we will start with a hockey metaphor. The above title is well-known advice to hockey players, meaning (1) stay alert so you don't get your head taken off and (2) be ready for the scoring opportunity whenever it presents itself.

That's the way we feel about investing these days too. It is indeed rough out there—enormous national debt in Greece, Italy, Spain, the UK and the USA (just to name a few), bloody conflict in Syria, Egypt, Nigeria, Afghanistan and elsewhere, bad actors in Iran, the conversion (hopefully short-lived) of America from a democracy into an ineptocracy, insider trading scandals, bankruptcies, underwater mortgages, consumer confidence down for the 4th straight month, slowing growth in China and Brazil, high unemployment, volatile stock markets and miniscule returns on safe haven securities. The parade of horribles seems endless. Fear and uncertainty rule the 24/7 news cycle.

So why the heck are we so chipper these days—the most so in two years? Because the pendulum has swung too far to the negative, and we believe there is a growing probability that it is going to start swinging back in the other direction. When the transition happens, it could happen in a big way as the trillions of dollars in safe havens (treasuries, gold, money market funds, etc.) move back into risk assets. To be sure, the benefits of the transition will not be uniformly spread across investment categories and geographic regions (e.g., Southern EU countries likely will continue to struggle). But we think it is time to start positioning capital in front of that transition, especially in certain areas of private equity. One prominent CIO summed it up with this rhetorical question, "Why shouldn't we be optimistic if we can do good deals at great prices?" Exactly. For brevity's sake, we will leave it at that, but please call us for a circumspect discussion of why we are beginning to distance ourselves from the doom and gloom crowd.

Noteworthy Q2 Matters

Q2 was very active but we want to highlight four particular items relating to private equity for you.

China

During the quarter, China's Economic Planning Agency ruled that all capital in RMB-denominated funds must come from local Chinese investors and foreign investors cannot invest in or raise RMB-denominated funds. At the time the ban was introduced, 60 RMB-denominated funds were being raised by foreign investors.[1] Frankly, this ruling merely puts into writing what has long been established—local private equity firms have priority over foreign funds in China. Non-RMB-denominated investments (and foreign investors in general) face significantly more stringent regulatory hurdles when making private equity investments in China. As a result, more time is required to complete a transaction for a foreign buyer versus a Chinese buyer. Typically, this delay leads sellers to prefer transactions with RMB-denominated funds. While foreign VC and LBO firms can still legally invest in Chinese companies, the deck is stacked against

[1] Reuters

them. Furthermore, foreign investors are banned from investing in defense-related companies and face many restrictions on internet, tech, telecom and education-related investments. Mixing the liquidity, corruption, political and other risks with this new development makes China pretty foreboding to foreign private equity investors.

Facebook

During the quarter, Facebook (Ticker: FB) completed one of the most anticipated IPOs of the decade. In pricing 421 million shares at $38 per share (representing an initial market cap of over $100 billion), the company completed the third-largest IPO in U.S. history. But from the start there was trouble. The stock opened nearly two hours late, pricing fluctuated wildly and then started heading south, underwriters were accused of sharing negative pre-IPO news with institutional investors but not with retail investors, etc. Within a few days, the market shaved off $25 billion of the company's market cap, many investors were threatening legal action and the IPO window slammed shut. Since the Facebook IPO on May 18, there have been zero IPOs (compared to 19 in the same period last year) and 14 companies have either postponed or cancelled their IPO plans, many of them citing the botched Facebook IPO as the main driver. Investor confidence in IPOs clearly has been badly damaged, with retail investors alleging they were played as fools by the underwriters of the Facebook IPO. Some companies are also concerned that underwriters might underprice any near-term offerings to ensure the price goes up (and avoid similar lawsuits from unhappy investors).

Three items of note:

1. Social media was on the verge of a bubble. This event has re-instilled some much needed valuation discipline.

2. The IPO window is at least temporarily shut, so expect a longer hold period for those companies nearing a potential IPO exit. Some (not all) of these companies will need additional capital to bridge them to an IPO or M&A exit.

3. The long-term impact, if any, on secondary (private) markets has yet to be determined. Facebook traded at $42/share on secondary markets prior to its IPO.[2] Buyers at those valuation levels are likely unhappy (and locked up to boot). Over the last two years, secondary markets had developed sufficiently to provide meaningful liquidity to existing investors and employees but some of this liquidity may dry up as potential buyers ponder valuations and the general lack of transparency there.

FDA

During the quarter, Congress approved the Food and Drug Administration Safety and Innovation Act, enabling quicker approvals for new drugs and medical devices. There are two primary components of the Act. Part one provides a broader accelerated approval process. Historically, accelerated approvals were permissible for a narrow list of drugs, like those to treat cancer or HIV. Now a wider array of drugs and medical devices qualify. Part two allows drugs that quickly demonstrate a significant positive impact on life-threatening diseases to have a faster and cheaper path to approval.[3] This is an important development for VCs focused on life sciences, all of whom had been adversely impacted the last few years by what had become an overly-cautious, bureaucratic FDA. We hope a better balance can now be struck between safety, expediency and development cost. The prospects for life science VC funds just went up a notch.

---

[2] Business Wire
[3] Reuters

Solar Tariff

During the quarter, the U.S. Commerce Department placed a provisional tariff of 31% on 61 Chinese manufacturers of solar cells in response to anti-dumping complaints from seven U.S. solar firms. The U.S. firms accused the Chinese manufacturers of selling their panels at average prices that are 31% below fair market value. *Solar panel prices have fallen by more than 75%* over the past four years, spurring demand worldwide and especially in the U.S.[4] China is a very large supplier of panels to the U.S. and the value of panel imports from China increased nearly 500% from $640 million in 2009 to $3.1 billion in 2011.[5] While there is speculation that this tariff will directly increase the cost of solar panels sold in the U.S. and lead to a decrease in demand, we generally disagree. Panels represent less than one quarter of the total cost of installed solar PV systems—with financing, installation and other infrastructure costs accounting for the rest. Also, Chinese firms can avoid the tariff by creative work-arounds, such as purchasing solar cells manufactured in Taiwan or South Korea and assembling solar panels from those cells in China. Given the tremendous excess manufacturing capacity for solar panels worldwide and further expected cost reductions in racking / balance of systems, we think the tariff will have a negligible effect on price and U.S. demand for solar panels.

Impact Report Now Available

At North Sky Capital, our focus when making CleanTech investments has always been to generate a strong return for our clients. However, we recognize that many of our clients also measure investment performance through impact related metrics. To help those investors quantify the positive changes their investments are making to the environment, we've published our inaugural ***Impact Report***. This report highlights the environmental effects of our investments as demonstrated within the context of reducing harmful emissions and intelligent resource utilization.

If you would like to receive a copy of the ***Impact Report***, please click here to submit your request.

---

[4] The Economist

[5] Financial Times

Upcoming Events

We are regular speakers and attendees at key industry conferences. We hope to see you at these upcoming conferences:

September 13-14	Abbot Downing Family Forum, Chicago www.abbotdowning.com
October 2-4	SRI Conference, Uncasville, CT www.sriconference.com
October 8-10	Nat'l Coordinating Committee for Multiemployer Plans, Hollywood, FL www.nccmp.org
October 22-24	FOX Fall Forum, Chicago www.familyoffice.com
October 24-25	Quebec City Conference, Quebec www.quebeccityconference.com
November 11-14	58th Annual IFEBP Conference, San Diego www.ifebp.org

North Sky Capital Contacts

Scott Barrington
Managing Director and CEO
(612) 435-7170
sbarrington@northskycapital.com

Danny Zouber
Managing Director
(612) 435-7180
dzouber@northskycapital.com

Michael Pohlen
Managing Director
(612) 435-7190
mpohlen@northskycapital.com

Mark Austin
Managing Director
(612) 435-7160
maustin@northskycapital.com

Gretchen Postula
Head of Investor Relations
(612) 435-7177
gpostula@northskycapital.com

Denise Galvin
Chief Financial Officer
(612) 435-7166
dgalvin@northskycapital.com

Megan McElroy
Vice President
(214) 459-3133
mmcelroy@northskycapital.com