

Private Equity Analyst

Clean-Tech Investing Grows Up As Market Forces Shift

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Not so long ago, limited partners regarded investing in clean technology-oriented funds as a way of potentially adding some heat to future returns. But long paths to exits, a dependence on government subsidies, and lower prices for oil and gas have made the investment terrain tougher to navigate.

But investors aren't necessarily throwing in the towel just yet. Instead, some are navigating away from riskier early-stage funds and strategies backing clean energy production in favor of investing in more mature deals and in deals that require less capital, especially those that help decrease energy use. They are also expanding into newer markets, like China, where the regulatory environment has gotten more favorable.

Clean-tech funds attracted more than \$8 billion in capital globally between 2004 and March 2010, according to a report by U.K.-based data provider Preqin Ltd., on the back of increased public and governmental awareness of the need to support green technologies. It's too early to say how many of the 204 vintage 2007 and 2008 funds that indicated a focus on clean-tech will ultimately perform well and like the broader venture industry, the sector has seen its casualties.

"A lot of generalist VCs made the mistake of not understanding the differences [between clean technology and other tech investing]," said Scott Barrington, managing partner at Piper Jaffray Private Capital. His team, which is spinning out into a new entity called North Sky Capital, has committed about \$300 million to clean-tech venture and infrastructure funds. "We saw people make investments that had longer runways than they traditionally had done and got burned."

More recently, clean technology funds have also suffered from the sluggishness in overall venture fund-raising, making it hard for firms, particularly early-stage ones, to garner LP attention. According to Preqin, no early-stage clean-tech funds reached a final close last year, compared with \$493 million raised by such funds in 2008.

Because the clean-tech sector is so broad, it's difficult to generalize about investment opportunities and performance. Solar energy projects, for example, in the U.S. are being installed at a growing pace, while wind energy project installations are down this year.

Even so, the long exit runway has caused some LPs to shift attention to later-stage funds. Danny Zouber, a partner at North Sky Capital, said that his firm had more exposure to earlier stage clean-tech funds in the mid-2000s, and has since decided that "you do not need to take the risk associated with earlier stage investments. We've seen plenty of terrific growth-equity expansion-stage opportunities in clean-tech. That's become our area."

He added that, thanks to some nice early returns, the firm's most recent fund is in positive territory. "We're sitting on 1.3 times [what] we've invested so far," Zouber said.

Some venture funds, such as Radnor, Pa.-based Element Partners, have moved out of early-stage into later-stage strategies. That said, there are glimmers of hope in the early-stage area. This year, Khosla Ventures raised a \$300 million seed fund with a significant focus on clean-tech, and CalCEF Clean Energy Angel Fund pulled in \$11 million for its debut fund to invest in pre-revenue start-ups.

Some recent exits, such as the initial public offerings of electric car company Tesla Motors Inc. and battery developer A123 Systems Inc., and the sale of solar developer Recurrent Energy LLC to Sharp Corp., have helped to bolster the mood in clean-tech venture circles.

Firms are also looking further afield in their quest for deals to countries like Israel and China, where the regulatory environments have grown increasingly favorable. "The Chinese are fervently moving to a cleaner, greener economy and they have a command economy which gives them the ability to drive the implementation of a wide spectrum of things," said North Sky's Barrington.

North Sky has backed several deals in China, including an infrastructure play in China Hydroelectric Corp., which went public on the New York Stock Exchange in early 2010.

Venture investors are also shifting to less capital intensive technologies, such as those in the energy-efficiency space, as another way of reducing risk of holding a company too long and over-committing capital to it.

Tucker Twitmyer, managing director at Enertech Capital, a venture firm investing in clean energy since 1996, expects a continued contraction in the number of clean-tech focused venture funds. However, he expects the survivors to have a better eye for recognizing long-term growth opportunities and clearer strategies for dealing with the challenges of clean-tech investing.

"We now have a maturation of learning," Twitmyer said.

-With reporting by Sabrina Willmer and Laura Kreutzer

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