North Sky
CAPITAL

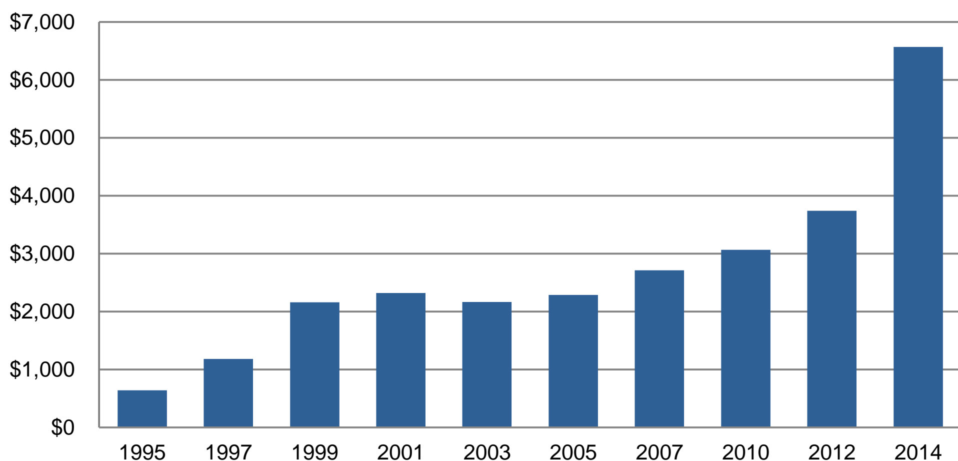
First Quarter 2015

Impact Investing Becomes Mainstream

Impact investing has existed for hundreds of years but it has grown enormously in size, scope, sophistication and popularity during the last few years. What was once the realm of a few—religious pension plans, environmental activists and a handful of others just 25 years ago—is now being widely embraced by Wall Street and investors of all types. In essence it has become mainstream.

According to US SIF Foundation, "The total US-domiciled assets under management using [impact] strategies expanded from $3.74 trillion at the start of 2012 to $6.57 trillion at the start of 2014, an increase of 76 percent. These assets now account for more than one out of every six dollars under professional management in the United States."

U.S. Impact Investing Total Assets Under Management[1]
($ in billions)



Impact investing has taken many forms over the years. In its earliest form, religious pension plans used negative screening to avoid sin stocks. Later, environmental and political activists would use shareholder proposals to demand that companies reduce pollution or otherwise improve their operations. Later still would come the cleantech revolution that brought us innovative technology companies like Tesla, Solar City and Nest, among many others. But until recently the number of participants had always been limited to a small minority of the overall investment community—environmental activists, kind-hearted individuals, a few political opportunists, technologists, futurists, philanthropists, religious organizations and charitable foundations seeking to improve the human condition. We joined this merry band in 2003-4, bringing our focus on investment returns to the mix and launching the first cleantech private equity fund of funds in North America.

It was a long time in the making, but we noticed in early 2013 that impact investing was on the verge of a breakout due, broadly speaking, to investor demand for sophisticated, reliable investment strategies that would both earn a decent return and do some good. The world had changed. As Thomas Friedman said, it was "flat" again. The Internet brought us all closer together and allowed the instantaneous exchange of ideas and increased collaboration. It also exposed the world's many flaws and beamed them

into our homes on YouTube, where they became too obvious to ignore any longer. By 2013, Wall Street finally woke up and began addressing the demand. Today, nearly every bank, broker dealer, wealth manager and investment advisor—US Bank, Wells Fargo, RBC, Ameriprise, Goldman, JPM, Morgan Stanley, Blackrock and Wellington—proudly trumpets its bona fides in impact/sustainable/ESG/mission related investing. Take your pick of ETFs, mutual funds, private debt/equity/infrastructure, water rights, African cell phone companies, Indian lighting endeavors, organic farming partnerships, etc. Similarly, the investors in these offerings are just as broad—from millennials to retirees, endowments to pension plans and foundations to 401(k)s. Impact investing has gone mainstream and that is a good thing.

Our goal for our impact funds is to be the gold standard of the industry in terms of return, impact and reporting/accountability. We seek to deliver double digit IRRs and to clearly demonstrate the "good" that we and our LPs create together. In addition, when it comes to our triple bottom line Alliance Fund strategy, we add high quality jobs to the mix. To wit, Alliance Fund I is on track to generate a strong return, to build more than 500 MWs of renewable energy power systems and to create approximately 1.3 million union hours of labor.

This year is going to be a very active and exciting one for impact investors, and we look forward to the opportunities ahead.

Returns Expectations

Private equity investors ought to be paid a premium return for bearing the illiquidity associated with private equity. Therefore we regularly check the returns expectations of the industry's top consultants. Below is a representative list.

Expected Return for 2015[2]	
Global Bonds	1.00%
Treasuries	1.75%
TIPS	2.25%
Core bonds[3]	2.30%
High-Yield Bonds	4.00%
Commodities	5.25%
Hedge Funds	5.75%
Large Cap Equities	6.00%
Real Estate	6.50%
International Equities	7.00%
Private Debt	7.50%
Real Assets / Infrastructure	8.00%
Private Equity	8.50%

Five brief observations:

- Returns expectations for 2015 are low across all asset classes
- 2015 predictions are down 23-50 bps from 2014
- The 8.5% returns expectation for private equity is the highest return in the chart
- Private equity returns historically have outpaced typical institutional portfolio return assumptions of 7-8%
- Private equity returns are expected to beat public equity returns by 150-250 bps

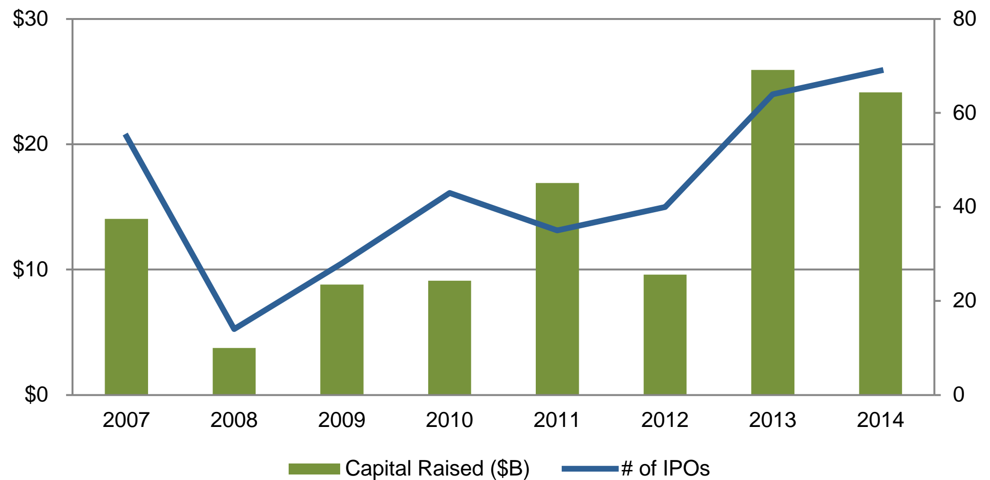
Private Equity Market Data

2014 was another good year for buyout and venture capital investors as returns and distributions continued to be strong. In our funds, 2014 continued to generate significant exit activity with more than 30 IPOs and over 65 M&A transactions, including GrubHub, Michaels and Lumena Pharmaceuticals. So far this year, our funds have recorded two IPOs (Box and Zosano) and eight M&A events. Additionally, we have over ten portfolio companies that have either filed for IPOs or entered into definitive agreements to be acquired.

The following charts show market activity for the entire U.S. private equity industry:

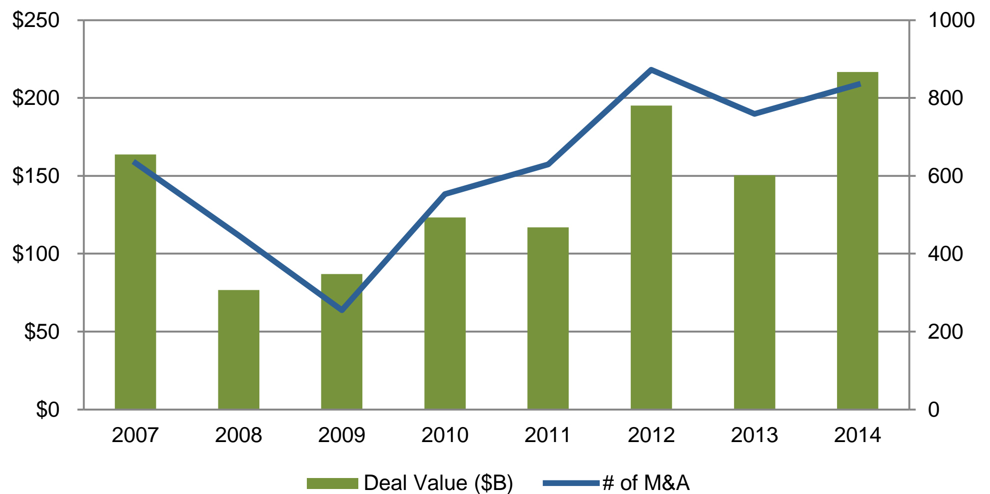
U.S. PE-backed IPOs[4]

- The number of IPOs is still on the upswing since bottoming out in 2008
- Capital raised has been very strong in the last two years



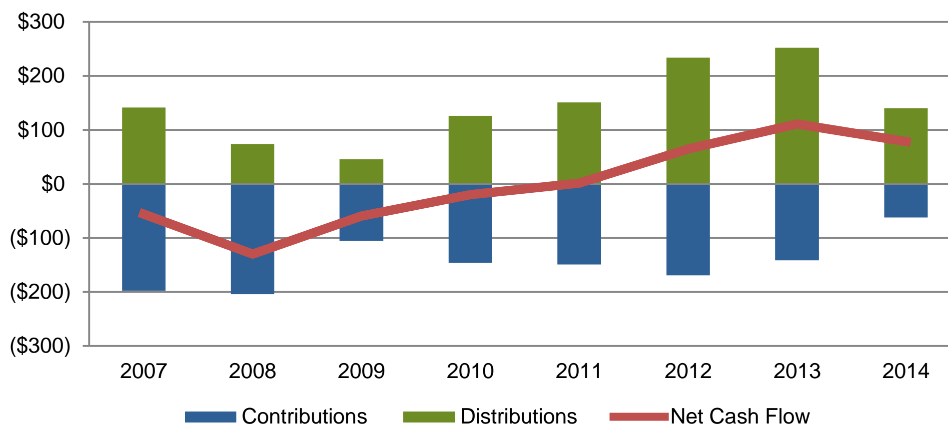
U.S. PE-backed M&A[4]

- M&A activity has been robust over the last three years



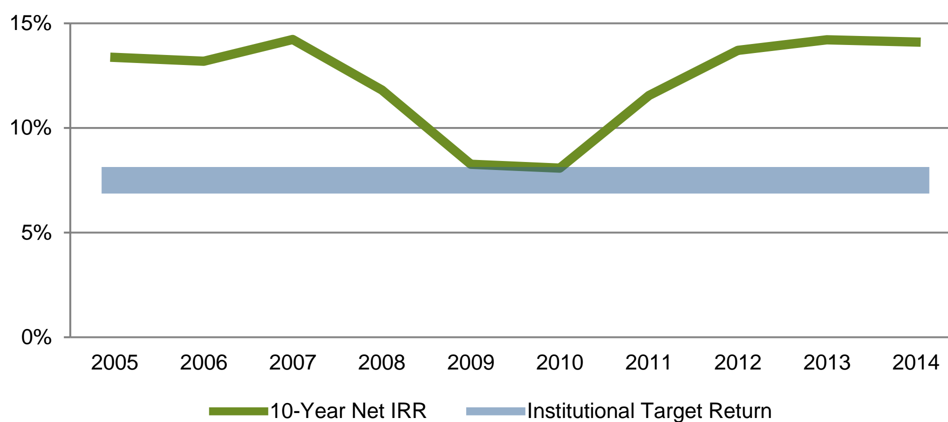
U.S. PE Funds Annualized Cash Flow by Year[5]

- Distributions from PE funds to LPs has exceeded contributions for the 4th year in a row
- Likely many institutional investors are having a hard time keeping their PE allocations up near their targets, so we expect more commitments to PE this year



PE Returns have Fully Rebounded Post-Recession[6]

- Returns were a healthy 14% again in 2014
- Good reward for illiquidity



Conclusion

We expect to see more and more investors use the might of their investment dollars to demand not only a financial return but also one or more additional benefits. Furthermore, given the high level of PE distributions over the last four years, investors will need to make significant new allocations to venture, buyout, infrastructure and other alternatives this year merely to maintain their target allocations to these asset classes.

North Sky Capital Contacts

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

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

33 South Sixth Street, Suite 4646
Minneapolis, MN 55402

[1] Source: US SIF Foundation and North Sky Capital
[2] Source: New England Pension Consultants
[3] Core Bonds is a blend of Treasuries, investment grade corporate bonds and mortgage backed securities.
[4] Source: Pitchbook.
[5] Source: Pitchbook. 2014 data through 6/30.
[6] Source: Cambridge and North Sky Capital

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