

CLEANTECH

Outlook for cleantech investment in 2010

BY SELINA HARRISON



The global recession has impacted investment levels across all sectors and industries, and the clean technology industry has been no exception. Furthermore, its fall has been steep – prior to the global recession, global cleantech investment across all asset classes reached a record-breaking \$40.3bn in the last quarter of 2007, and investment levels have since failed to return to those heights. Nonetheless, figures from the last two quarters show that cleantech investment is on an upward trend, fuelling hopes for a strong recovery in 2010.

Green growth in a distressed market

In 2009 to date, investment in the global cleantech industry has been unpredictable. For example, the \$25.9bn invested in Q3 2009 was 9 percent less than the \$28.6bn invested during the previous quarter, according to New Energy Finance. However, the \$25.9bn invested during the third quarter is almost 200 percent more than the \$13.3bn invested during Q1 2009 – indicating an overall upward trend. It is widely thought that this coincides with an overall improvement in the economy, but as no region in the world has demonstrated a strong recovery, there is not enough evidence to make a strong case for this view. What is clearer is that the various government stimulus packages launched across the world have been instrumental in keeping the sector afloat. Private invest-

mentors, particularly venture capitalists, are also investing a sizeable (and increasing) portion of cleantech project funding. “Cleantech investing by US venture firms has grown from under 5 percent of venture investing just several years ago to 15 percent of venture investing in 2008,” asserts Mark Heesen, president of the National Venture Capital Association. Further, it is predicated that in the US, cleantech will be the single largest recipient of venture capital funding in the near future and according to the Cleantech Group, cleantech accounted for approximately 25 percent of all venture capital investment during Q3 2009.

This is broadly split among various clean technologies. Of the \$1.6bn invested into cleantech by venture capital firms across the world during Q3 2009, two thirds was invested into US-based firms, according to Cleantech Group data. Of the \$1.6bn, solar-based technologies received \$451m, the largest portion of overall investment. This was spread across five solar deals, the largest being the Solyndra transaction worth \$198m. Next were cleantech transportation technologies – such as vehicles, batteries and biofuels – which generated \$383m of venture capital investment. Third was green buildings investments, which attracted \$110m worth of venture capital. This is to be expected – investors will naturally look where their knowledge can be most applied. “In the current economic climate, investors will support exist-

ing investments and those business which they understand and generate cash flow rather than invest in and take on technology risk,” suggests Brent Goldman, a partner at BDO LLP. However, proven technologies are just one side of the cleantech market – there are also new technologies that are yet to be proven and commercialised, and these are struggling to attract investment. “There are few companies that fall within the middle, and these two extremes have different factors that are affecting the level of investment,” adds Mr Goldman.

Similar trends have emerged in Australia, but for slightly different reasons, according to Dermot Duncan, a senior lawyer at Crisp Legal. “Due to Australia’s late action on climate change and small market, many investors are not green tech savvy and favour mature technologies over pre-commercial technology due to inherent regulatory risks and the current desire to profit-take. There is also the issue of ‘path dependency’ – it is taking time to change the investment choice from fossil fuel to cleantech, and supporting investments is more attractive once some investments have already been made.” This ‘path dependency’ is steering Australia’s commercial response to those technologies compatible to our fossil fuel industries, namely energy efficiency measures in those industries (i.e. exploiting coal bed methane, natural gas although this is coupled with huge investment in unproven Carbon Capture Storage) rather than aggressive investment in cleantech or mature renewable energy.

He adds that Australia’s late regulatory response to climate change has created an uncertain environment, which is also holding back the growth of the cleantech industry. At present, Australia has just a single ‘national’ regulatory driver, the Renewable Energy Trust (RET) (although some State Governments are implementing strong Waste Levies and Feed-in Tariffs), which aims to ‘pull’ commercialised technologies across ‘the valley of death’ into the market. However, there are concerns that the incentive may have been spread too thinly, in that other, less appropriate technologies (such as solar hot water) have been allowed to participate. This has served to distort the price of the Renewable Electricity Certificate

(REC), and further, is causing an oversupply of RECs, ultimately reducing the impact and appeal of cleantech.

Meanwhile, “Australia’s Carbon Pollution Reduction Scheme Bill (‘CPRS Bill’) sits in the Senate: with no guarantee that it will be passed either before or after Copenhagen’s Conference of the Parties in December 2009 (‘COP 15’), due to political opposition from the Liberal/National Party and aggressive lobbying from the polluters,” continues Mr Duncan. A point in case is that electricity prices rose approximately 20% in NSW last quarter and there is no ‘carbon price’: as compensation was ‘interestingly’ paid to liable entities under the RET, so we can expect electricity prices to increase once the CPRS Bill is enacted (even though compensation will be paid) - but, this will stimulate cleantech investment as it will ‘pull’ commercial ready technologies into the market that become price competitive. Clearly then, the regulatory response needs to be structured more effectively in order to encourage investment at the required levels.

Other governments have been more focused in the fight against climate change, but whether this has aided the recovery of the cleantech market is debatable. “Overall there is a lack of clarity in the market around green stimuli and their implementation, and therefore a gap between the rhetoric and how it is actually impacting businesses,” says Mr Goldman. For example, in the US, the government stimulus has had both positive and negative effects. Notably, all of the top four venture capital deals in Q3 2009 benefited from US government support. This is a fairly clear indicator that state-support is attracting private capital to the cleantech sector. However, there are concerns that these stimuli are distorting the market, picking ‘winners’ whilst lacking an overall strategy. Taking smart grid and water technology as two examples, the short term impact of the stimulus has been to stall private capital expenditure, rather than to let it flow. “Part of the current torpor in cleantech investments is being caused by the government stimulus,” asserts Rick Fratus, a senior vice president at Macquarie. “Certainly the economic environment is the major cause, but why would a private equity or venture capital firms invest in a company when the next week, the Department of Energy might announce a major grant or loan to a competitor?”

However, Richard Youngman, a managing partner at the Cleantech Group LLC, thinks that these commitments, whatever private capital’s view on them, will undoubtedly boost cleantech investment in the coming years. “It is worth remembering that the commitment

from governments around the globe has been enormous – up to \$400bn, some estimates say. The majority of these funds are expected to be allocated in 2010 and 2011 and so there will be levels of public investment capital flowing into cleantech over the next few quarters that would have been unthinkable 18 months ago. This will be an important theme in 2010 and beyond. It is rational for private capital to play behind the impact of Stimulus fundings, not in front of them,” he adds.

Making deals, moving on

In terms of the deals that are being done, post-commercialised clean technologies are easily the most prolific, largely due to their dependable investment returns as well as a lack of regulatory certainty. In contrast, new technology businesses rarely have the option to borrow heavily, and are therefore reliant on their ability to sell an equity stake. At present, these companies are looking for funding from government grants, private equity and venture capital firms, and R&D tax incentives and private wealth funds. However, securing investments for these deals is difficult, so consequently, they are typically structured as joint ventures: typically with a robust counterparty (i.e. electricity retailer or financial institution) This can be frustrating, but in the current financial environment, investors in clean technology need to be cautious. Debt and convertible debt instruments are often used to provide downside protection. New equity financing rounds are also seeking more protection, requesting writedowns of company valuations which give more equity to new investors and dilute previous owners who can no longer participate. But overall, the basic tenements of deal structuring will always apply. “The pre-completion phase is about preparing the business properly: making sure that a quality management team is in place, funding needs are clear, strategy and route to market are clear, and that any intellectual property is properly protected,” explains Mr Goldman.

Legal and regulatory changes will also have a significant impact on the cleantech market. Some cleantech businesses, such as smart metering, are already economically viable. However, most businesses will need to be driven by demand for carbon reduction targets and carbon pricing so they can compete against traditional technologies. “One of the biggest factors will be the speed at which regulatory and legal changes take place, which will be an indicator of how fast utilities and other industry participants will adopt cleantech solutions,” notes Mr Fratus. However, many countries are still awaiting such legislation. For example,

in the US, there is no carbon cap and trade scheme in place to stimulate green investment. As such, clarity over the regulatory environment for cleantech projects will be significant in the years ahead. “The response to climate change is predominately regulatory, so a strong understanding of climate change laws is imperative to any cleantech project. Changes in laws and regulations are a major risk in cleantech investment because much of the financial structure is based around revenues from economic incentives in the first 20 years or so of the investment (approximately 50 percent), so as to assist the company to complete on a level playing field with the established fossil fuel generators,” points out Mr Duncan. He adds that if Australia does not pass its CPRS Bill, the negotiations in Copenhagen will be important, if not crucial. “If a ‘binding’ international agreement, or at least a highly developed political agreement, does not result from COP 15: the voices of doubt will grow louder.”

Things are far more advanced in Europe. The European Union has the EU Emissions Trading Scheme, and the UK has a much firmer policy framework in place, including its ‘Low Carbon Transition Plan’ and Climate Change Act. This legislation has set firm carbon budgets for the economy as a whole, making it easier to attract investment into cleantech projects. There will always be investors who believe that cleantech is too niche, but in general, clean technologies cover every industry in some respect. “Cleantech success is closely tied to industries associated with new technology. For example, advanced battery companies focused on cars will need a strong recovery in the automotive sector or a strong value proposition that takes market share away from the incumbents as the industry grows,” says Mr Fratus.

Legislation and policy aside, the recovery of the cleantech investment market will ultimately be influenced by the race to dominate the global clean energy market. Indeed, China has seen the business potential of the green industry, and is moving swiftly – it is set to become the world’s leading manufacturer of wind turbines this year, and is already the top producer of photovoltaic cells for solar energy. Overall then, there is significant interest in the cleantech sector, and the ability to find and back viable new technologies will separate the sheep from the goats. This may not be appealing to some investors, who are still spooked by the uncertainty of the current economic environment. However, a lot of money is available for investment in cleantech, and it is likely that there will be significant and lasting growth in 2010 and beyond. ■

This article first appeared in FinancierWorldwide's *December 2009 Issue*.
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