RED HERRING

POWERING THE ENERGY SECTOR

Venture capitalists give a green light to ENERGY STARTUPS.

VC WHISPERS

TOM STEIN

THE ENERGY industry isn't exactly a top priority for most VCs. After all, for a long time energy was a regulated, slow-moving industry that wasn't known for technological innovation. But thanks to deregulation and the industry's newfound willingness to embrace Internet technologies, VCs are starting to take a closer look at the sector. A growing number of new VC firms are devoting themselves solely to energy investments, and a handful of mainstream firms are starting to build dedicated energy practices.

Investments in energy companies are taking a number of different forms.

> Gas and electricity sales on the Net will climb from $1 billion in 1999 to $266 billion in 2004.

Some VCs are betting on startups that develop software and services for the utility companies themselves. Another popular—if not already saturated—investment opportunity is Internet auctions, in which everybody from wholesalers to retail consumers can purchase energy. Companies with names like **Altra Energy Technologies, Enermetrix.com, HoustonStreet.com, Automated Power Exchange, Excelergy,** and **NetworkOil.com** have piled into this market.

A few brave VCs are investing in new technologies designed to replace existing energy sources. These include fuel cells, microturbines, and proton technologies, as well as a variety of "green energy" options. The thinking behind these investments is that either existing utilities will pick up the technologies, or large corporate end users will purchase and manage them. Tim Woodward, managing director at Nth Power Technologies, a VC firm that focuses exclusively on the energy industry, believes that companies don't want to have to rely solely on the power grid for their energy needs. "If there's a brownout, McDonald's still wants to light up its golden arches," he says. Nth Power, for one, has invested between $2 million and $5 million in a number of startups—including **Capstone MicroTurbine, Metallic Power, Proton Energy Systems,** and **Evergreen Solar**—that are developing new energy sources.

Investment in the energy industry is steadily gaining momentum (see chart, next page). Experts say VCs' interest and excitement has a lot to do with a general improvement in the quality of energy startups and their ability to attract seasoned managers from more traditional IT sectors. According to the research firm Venture Economics, private investors poured $300 million into the energy technology market in 1999, up from $150 million in 1998. That's a drop in the bucket compared with the billions being poured into pure Internet investments. However, industry watchers say energy will follow in the footsteps of telecommunications: once telecom was fully deregulated in the United States, the floodgates opened for a raft of new carriers and technology providers, as well as an overwhelming amount of venture capital. So far, the energy industry, which includes everything from oil and gas to electricity, is only in the first stages of deregulation.

To date, the biggest chunk of venture money has been targeted at online energy exchanges. That's not surprising, since the IT consultancy Forrester Research expects natural-gas and electricity sales on the Internet to climb from $1 billion in 1999 to $266 billion in 2004. VC firms like Battery Ventures have spent the last few years positioning themselves for the explosion. As early as 1997, Battery Ventures began actively investigating vertical markets and quickly determined that the deregulating energy industry could represent a huge opportunity.

So far, Battery Ventures' investments include Altra, which operates Internet exchanges for the oil, gas, and power industries; **Excelergy**, which targets the retail energy industry; **CheMatch.com,** a trading system for buyers and sellers of chemical products; and **WorldOil.com,** a publisher of trade magazines for the oil industry that is attempting to morph itself into an online marketplace for supplies like pumps and valves. All told, Battery Ventures has invested about $50 million of the $650 million under its management in online energy exchanges.

JUST HAVING FUNDS

Critics of online energy exchanges argue that there is too much venture money being thrown at too many business plans, many of which will never progress beyond the embryonic stage. Still, entrepreneurs in this industry have an easy story to tell, and VCs are eager to listen. "Energy is a huge market in the midst of deregulation. It has a big e-commerce component," says Altra chairman Rusty Braziel. "VCs are hungry to get a piece of this."

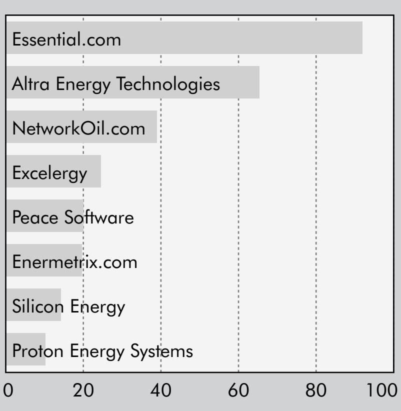
But creating a viable technology platform is more easily said than done. Even Dave Tabors, a principal at Battery Ventures, believes that a shakeout in online energy exchanges is just around the corner. "At the end of the race, there will only be two or three players left standing," he says.

It's still unclear whether VCs can convert their energy investments into blockbuster IPOs, especially in light of the market's recent volatility. So far, the reaction of the capital markets to energy plays has been mixed. Take, for example, **GreenMountain.com,** which provides environmentally friendly electricity to consumers. The company had to cancel its IPO, which had been scheduled for last summer, after Wall Street concluded that its business was even less viable than most half-baked Internet retailing schemes. Still, that didn't prevent a group led by BP Amoco from investing $100 million in GreenMountain.com in May. On the other hand, **Plug Power,** a developer of fuel-cell technology, went public in November and has seen its share price shoot up from $15 to as high as $156.

Naturally, VCs want to believe that most energy companies will be as successful as Plug Power. "I think the capital markets will be very receptive to this space," says Jake Tarr, managing director at Kinetic Ventures, which is currently raising a $150 million second fund exclusively for energy investments. "Even the larger investment banks are starting to build practices dedicated to the energy sector, with the aim of taking many of these new companies public." Indeed, all of the VCs interviewed for this article claimed to have at least one energy play on the verge of going public in their portfolios.

FUNDING POWER

Some leading energy/technology companies and how much they raised ($M).



SOURCE: VENTURE ECONOMICS

For Insight Capital Partners, the energy sector is undeniably attractive.

> Cadence, for one, claims its software can help clients save up to $500,000 a month.

Over the past two years, the firm has invested about $100 million, or more than a third of its capital, in energy deals. Along with online energy exchanges like Enermetrix.com and **DownstreamEnergy.com,** Insight has bet on the likes of Peace Software, a provider of Web-based customer-information and billing systems for utility companies, and the Convergent Group, a provider of e-commerce systems-integration services for energy companies. Before deregulation, says Insight managing partner Jeff Horing, utilities used antiquated, homegrown systems. But to compete in a deregulated market, these companies will have to adopt new billing systems and meter-reader technologies that can account for both the acquisition and loss of customers in a competitive environment.

The newest addition to Insight's energy stable is the **Cadence Network,** an e-commerce company that specializes in energy cost-reduction services for such national retail chains as Blockbuster Video. In the past, a retail chain might have received 3,000 separate utility bills. No effort was made to analyze the bills or squeeze out savings, because the prices were fixed.

But in a deregulated market, energy suppliers will have to compete on price and service. Already, corporate customers are looking to Cadence and other software providers to determine the cheapest energy rates, consolidate their bills on a single statement, and analyze consumption patterns. Cadence, for one, says that its software can help some clients save up to $500,000 a month in energy expenses.

VCs also are keeping a close eye on the emergence of so-called Internet utility companies. Startups with names like **Utility.com** and **Essential.com** are attracting residential and small-business customers with all-in-one packages that include electricity, gas, telephone, cable, and broadband services. Companies buy these services at wholesale rates and then resell them to consumers at discounts of as much as 20 percent. Customers get a single, consolidated statement each month.

Essential.com has raised a whopping $92 million in three rounds of funding from Amerindo Investment Advisors, Bessemer Venture Partners, Comdisco Ventures, and EnerTech Capital Partners. Utility.com has raised a total of $36 million in two rounds from Idealab Capital Partners, Trident Capital, and Kinetic Ventures, among others.

POWER SURGE

John Woolard, CEO and cofounder of **Silicon Energy,** which makes energy management and analysis software, believes it's easier for entrepreneurs in the energy industry to raise money today, compared with a few years ago. "Early on, we had to put a heavy software-technology spin on our business, because energy just wasn't interesting to the classic VCs," he explains. "But today, the energy space has a higher profile. Companies in the sector are more mature and are pursuing real business models."

The result, says Mr. Woolard, is an ever-increasing number of venture firms specializing—or at least dabbling—in energy. Silicon Energy, for instance, has raised $19 million from Nth Power and Integral Capital Partners, a firm known more for its Internet and IT investments than for its energy plays.

"It's still hard to tear most VCs away from the Internet," concludes Mr. Woodward of Nth Power. "But I wouldn't be surprised to see even more action from the traditional venture investors."

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