

VC industry goes hunting for gold in utilities mart

In a signal that the revolution that has engulfed the electric utility industry for much of the decade is now giving way to reconstruction, venture capitalists are starting to fund start-ups that they believe will be able to carve niches in the decentralized utility market of the future.

Nth Power Technologies Inc., for example, is now seeking investors for a new fund, expected to close by mid-2000, that will provide capital to companies that stand to benefit from the collapse of traditional electric utility monopolies. The fund should be in the \$75 million to \$100 million range, and will make investments in individual companies ranging from \$1.5 million to \$3 million.

The San Francisco-based company, which already has one \$65 million fund that is nearly fully invested, is already providing initial funding to companies that offer such products as portable generators, systems to facilitate remote electric meter reading, efficient lighting systems and rechargeable fuel cells.

"We're just at the beginning of the growth curve," said Maurice Gunderson, principal and co-founder of Nth Power, whose ultimate goal is to run a fleet of similar funds with investments in some of the most profitable and critical companies in the newly revolutionized industry.

To be sure, the decentralization of the U.S. utility market is far from over, as it is proceeding on a state-by-state basis. But the challenges to the revolution, such as the lawsuits filed against securitizations of utility-stranded assets, have so far been repelled and no further obstacles are apparent.

The time to pick the next generation of winners is now, according to venture capitalists like Nth Power. There will not be a top tier of major players who will dominate the entire industry, as has happened in part in telecom, Nth Power argues. Rather, the utility industry will be segregated into a variety of billion-dollar sectors, each of which will have its own major players.

Enter financial entrepreneurs

While the fund is one of the first pioneers in this field, it doesn't expect to be alone for long. Nth Power's founders said that there is room for more than 20 venture capital funds of comparable size in the market, with room left over for latecomers.

"We're now seeing financial entrepreneurs attracted to this industry for the first time," said Hugh Holman, a senior researcher at Robertson Stephens who specializes in utility deregulation and its impact. "Nth Power and other individual entrepreneurs are looking at the power business as an arena of opportunity."

Essentially, Nth Power reviews nearly 90% of the new companies that are emerging from the deregulation revolution now underway in both the U.S. and Europe, and tries to find small companies that provide tools that will become indispensable to larger utility players.

"These [funds] do a very good job of looking at hundreds of technologies that are emerging out there, and providing seed capital as well as second- or third-round financing to nurture them to the point where they can become bigger entities," said Robert Chewning, vp of energy/utility research at Morgan Stanley.

For example, Nth Power now invests in Capstone Turbine Corp., which manufactures microturbine generators that meet the demand of commercial businesses for localized power sources and reduce their reliance on an electricity grid. Nth Power said they invested in a company like Capstone because they believe that power generation in the future will move to a much more localized level, and thus the need for a power provider to have access to such generators will make the value of a Capstone substantially increase.

Already Nth Power's bets look to be paying off. Of the 13 companies to which Nth Power has provided funding, several look likely to issue initial public offerings or possibly be acquired in the next year. Observers said that for a venture capital fund, such a fate is one of the most desirable ways to wrap up investments in a startup company.

Sea change

Nth argues that the utility industry today roughly stands at where the telecommunications industry was in 1981, when several court rulings and laws had basically laid the framework for the decentralized world to come, but before the flood of investment capital entered the market.

For example, annual venture capital investment in telecommunications did not come close to \$200 million until 1982, when the final court order was filed in the AT&T v. the U.S. case that led to the breakup of the U.S.

telecom monopoly. Two years later, there was about \$500 million in annual venture capital in telecom, and that volume neared \$1 billion by 1988.

How does that compare with the utility industry? Annual venture capital investment only topped \$100 million in 1997, three years after the utility restructuring began in California that kicked off the deregulatory boom. Nth Power began raising its first fund in 1996, when only a trickle of capital was entering the market. But in the next five years, the prediction is that venture capital could reach the \$500 million range or higher.

That is because many of the top players in the electric utility industry are now running scared. Having grown accustomed to having a monopoly for most of their existence, utility providers are now having to handle such business aspects as marketing, and have not grasped that disparate operations like distributed generation and storage, end use products and power quality could be run by

a bevy of different companies.

But the more adept utilities have begun allying with the venture capitalists, analysts said. By doing so, a utility can get a toehold in a developing technology market without having to part with too much cash. Nth Power's current investment partners include PacifiCorp, Cinergy, Sierra Pacific Power Co., Electricite de France and CapTech, a subsidiary of Hydro-Quebec.

But investing in cutting-edge utility technology is no easy matter. Nth Power was praised for its strict devotion to the utility market, rather than running funds in a variety of sectors with a mastery of none. And Nth officials acknowledge that finding the right investments depends most of all on determining which management teams can fulfill their goals, and which technologies will be in for the long haul. In the words of Nancy Floyd, founding partner and managing director of Nth, "Venture capital is more than just writing a check." **Christopher O'Leary**

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