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New Economy Focuses on Energy Ideas - By Ken Silverstein

If the “New Economy” still has resonance, the emphasis might now be on the production of innovative technologies. Clearly, voids exist. The transition to a digital world has touched everything from the flow of electrons to the production of them. And that means new investment is needed in transmission, generation and clean energy tools.

Attracting capital is the immediate hurdle. And venture capitalists are far more conservative than they were five years ago. But still they do wet their lips at the right opportunities and once again are beginning to invest in projects where they see bright financial futures. Investors now have their eye on power grid optimization, information technology and energy management. And in a vote of confidence for the “New Economy,” the nation's biggest pension fund, CAlPers, just said it would pump $200 million in clean energy technologies over the next several years.

“What will be the big job generator of the next decade?” asks former President Bill Clinton, in a speech last year in Washington, D.C. “What's our information technology answer to this new decade? My favorite is energy … There is by common consent a trillion dollar untapped market for clean energy and conservation technologies...”

Venture capital investment in the United States for energy technology-related start-up companies reached $428 million during 2003, about even with the $435 million raised during 2002, says Nth Power, a San Francisco-based energy venture capital firm. The 2003 figure represents 2.3 percent of the total $18.2 billion in venture capital investments made in the United States last year. Worldwide, energy technology venture capital funding totaled $526 million. That's down from $584 million in 2002, with 84 deals completed last year averaging $6.26 million each. That compares to 55 deals averaging $10.61 million during 2002.

Nth Power analyzes venture capital activity by six industry sub-sectors. The highest growth, it says, occurred in information technology, which grew by 27 percent in 2003 and power optimization that rose nearly 42 percent. The investments that declined last year include distributed generation and storage, which fell by 31 percent. Meanwhile, services and power quality were off by 51 percent and 9 percent, respectively.

The steady growth of energy tech's percentage of total venture capital activity is part of a five-year trend showing the category as increasingly visible and important, says Maurice Gunderson, co-founder and managing director of Nth Power. “As the industry and

its customers find themselves going from crisis to crisis, there is a growing realization that patchwork solutions are not going to solve the challenges facing energy producers and users. The emergence of new technologies and their adoption are capable of fulfilling the promise for solving systemic problems involving how we generate, use, track and manage power."

Measured Risk

While there are no hard numbers as to what the utility industry is allocating in the aggregate to venture-capital enterprises—as opposed to research and development (R&D) —the evidence suggests that their budgets have been cut way back. The average R&D investment per utility dropped from about $9 million in 1995 to $3.4 million in 2000, according to UtiliPoint's analysis of FERC Form-1 filings. According to PG&E's FERC Form-1 filings, it reduced its R&D budget from $18 million in 1995 to zero in 2002.

Still, utilities with deeper pockets have established venture capital arms. Venture capital investing is a method by which utilities can learn about new business opportunities without having to risk unlimited capital. Such investments, while uncertain, are a means of investing in emerging technologies that could affect their core operations. In addition to the 35 percent returns that most companies hope to achieve over a five-year time frame, the outlays must expand the parent companies' markets for its products and services. Electric and gas utilities new to the area but some of the leaders include DTE Energy, Exelon Corp., Hydro-Quebec CapiTech, Ontario Power's OPG Ventures and Koch Ventures.

Utilities, which are investing mostly in energy technology ventures, have provided anywhere between $1 million and $25 million in a single shot, although they will not typically own more than 20 percent of a given endeavor for regulatory and accounting reasons. Nevertheless, if the opportunity is right, such provisions will not prevent most utilities from increasing their positions or even acquiring a company outright. Utilities subject to the Public Utilities Holding Co. Act, however, need to comply with certain ownership restrictions imposed by the law.

Utilities vary as to when in a company's life cycle they seek to invest. Koch, for instance, will do so generally in the early-to-middle stages while Exelon will do so generally in the mid-to-latter phases. Many utilities prefer emerging and rapid growth companies that have potential to revolutionize their industries. Oftentimes, the investment arms desire to take an active role in the companies in which they directly invest by either acting as observer to or a participant in their board of directors.

And private investors are beginning to perk up too. Denver's Altira Group has said it will invest $2 million in Southwest Windpower, an Arizona maker of wind turbines. Ira Ehrenpreis, a partner at Technology Partners, says that venture capitalists have more money to invest than before. But, they are more interested in other sectors of the economy. And that leaves firms that are focused on energy technologies a chance to scoop up some good deals.

“We see more funds expressing interest in the energy area, but it still is very much a niche play with a number of strong niche players,” adds Hap Ellis of RockPort Capital Partners. “Valuations are generally fairly reasonable. Funds want to put money to work. And, as always, companies with strong management teams and compelling technologies will be successful in this market.”

American Garage

Energy is the fuel that makes the entire economy run. While the “New Economy” is still maturing, some concepts have emerged that could spawn viable enterprises. In the eyes of today's venture capitalists, it appears particularly true for such ideas related to power grid optimization and renewable energy. But more capital is necessary to bring creative thinking to market. Some venture capital firms are spotting those possibilities.

Meanwhile, utilities have to know what is happening in every corner of the marketplace—and that includes America's garages. It's risky and the extent of a utility's involvement should be carefully considered. But it could be prudent to properly finance R&D, especially in areas that will affect the strategic units of the company—over the short and long terms. Those that don't exploit those opportunities could be bypassed by those that do.