



## TRANSCRIPT

LegalMindsTV Exclusive Interview:

### **"Venture Investments in the Cleantech Sector"**

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To view the video of this interview, visit :

<http://legalminds.tv/index.php/2009/12/16/venture-investments-in-the-cleantech-sector/>

#### **Before we get started, can you tell me a little bit about your practice at Sonnenschein?**

Sure. I am a Corporate Generalist, essentially. But I tend to work a lot with younger emerging technology companies in the cleantech sector and investors, strategic buyers, venture investors investing into that same set of companies. So a lot of what I do is on the financing and M&A side, but also I act as sort of an outside General Counsel to these younger companies who might not have internal legal counsel.

#### **How would you define the "cleantech" sector?**

Cleantech is a name that's been – it's almost like nanotechnology that was slapped on an industry – when it really is not a single industry at all, but a very broad definition that goes across a number of sectors. Certainly, probably the largest component of what I'd consider to be cleantech, would be renewable energy. But also, it goes beyond that into green products, green buildings, efficiency technologies and grid management, smart growth, efficient vehicles. So there is a number of different sectors that are very diverse within that cleantech umbrella.

### **What's your view of the state of the market this past year?**

Well, like everything else 2009 was a tough year, certainly a down year. Not a lot of new investment activity. I think the funds by and large were spending a lot of time with their existing portfolio companies while blocking and tackling on the existing portfolio and not really looking at the new deals. The funds were there. They've raised their funds and they're committed in their funds and they've got the money to spend, but to a certain extent I think, they were sitting on their wallets, as they were preoccupied with the existing portfolio and also waiting for valuations to settle out.

Coming into 2008, the bottom fell out of the market very quickly. The expectations weren't really aligned between the companies and the investors. I think that's settled out a bit now. It's not back to where it was, but I think it's stabilized and we're seeing a number of new deals getting done, a lot of term sheets coming in and things looking better for next year.

### **What are seeing generally as far as venture financing in the cleantech sector?**

Over the past several years, there's been a great deal of interest both from new funds being raised that are dedicated to the cleantech sector, but also old line traditional VC funds that might have previously been focused on IT, we see them moving a little bit into cleantech investing as well. I think that trend will continue. A lot more dollars are being invested in the sector. Certainly the last year than the previous year.

### **How have you been advising your clients in terms of the strategic value of the cleantech investor versus people that are shifting their focus from investments in IT?**

So, as for the IT type investors that are coming into the cleantech space, they still can add a great deal of strategic value to cleantech companies, particularly here in the New York area where a lot of the cleantech companies we're seeing are energy efficiency technologies, grid management, or load management that really have a strong software and technical component to them.

Certainly it requires a different set of strategic contacts than you might have in a, say a digital media company, but a lot of those traditional IT firms can still add a lot of value on those new technologies in the cleantech sector.

**How have changes in the current market climate affected deal terms?**

Deal terms in the past year or so have not changed as much as you might have thought they might have, given the slow down.

Valuations certainly have come down a great deal, but when we look at things like liquidation preferences and anti-dilution protection, terms that back after the first bubble burst in 2000-2001 really changed drastically, those terms have remained fairly static because investors are looking to continue to keep management properly incentivized. So by putting a two or three or four-time liquidation preference on top of management, interests are no longer aligned properly.

So while you see the valuation pressures, we haven't really seen the pressure coming to bear on companies in terms of deal terms.

**What changes have you seen having an impact on deal terms?**

One thing that has had an impact on deal terms is the overall slow down in funding, both at the early stage and for cleantech companies at the later stage as well. As companies become a little bit more, I won't say desperate, but as their options become more limited for financing, certainly the investors may exert a little bit more leverage and exact some terms that they might not have been able to in an otherwise competitive deal.

**In light of this "desperation," for lack of a better term, what are some other alternatives to venture capital that companies in this sector are exploring?**

In certain segments of the financing markets, traditional VC funding is not always readily available. For example, at the really early stage, a lot of the funds have moved upstream a little bit and aren't really investing in those typical seed-stage investments.

Historically, we've seen angel investors fill that gap. Over the past year, angel investing, I think, was probably hit a bit harder than VC investing, and that typical angel dollars that are going into the company are really discretionary funds that the investor has and it's a discretionary investment. Those dried up pretty quickly, so we certainly have a little bit of a funding gap at that really early stage.

With cleantech companies, there is – I've heard some refer to it as the 'Valley of Death' that once you get beyond that typical technology investment for companies that are very capital intensive and are going to need a lot of dollars to, say, deploy a project and actually launch the technology that funding is not really available right now. The project financing markets still are not back to where they need to be to roll those kind of large projects on new technologies.

I have one client, an investor who's looking at investing into a new renewable technology and while the technology is very well developed, it hasn't been proven out in a commercial scale. So as we look at their financing plan, they not only have to invest in the company for finishing the technology development, but they also have to plan on investing in that first project and a bigger equity component than they probably otherwise would have because the debt financing won't be available for that first proof of concept project.

### **Has federal funding been a significant factor in the cleantech sector?**

With the announcement of the stimulus package earlier this year, it appeared that there would be a large amount of non-traditional funding, potentially non-dilutive financing, available for some of these companies through the stimulus plan. That has proven to be true in a number of cases, and I think it still remains to be seen exactly how that money is going to be rolled out.

We've seen a number of the stimulus projects coming out, the ARPA-E financing for technology innovation. There were about 45 grants made in, I think, October of 2009 totaling about \$150 million of the \$400 million that was slated for the overall policy.

Also there've been new DOE loan guarantees that have been rolled out. And some of those are reaching the segment of companies, the emerging cleantech company. Many of them are seeking and we are helping a lot of our clients actually worked their way through that application process.

**What kind of response has the investment community had to this type of financing activity?**

I think the investment community views it as a value-add and is not necessarily making an investment decision based upon the availability of stimulus financing. Just as easily as it came, it may go away. So they are looking at the underlying business, making sure that is solid and making the investment decision based on that.

**Are there any technologies that you think are most attractive to investors?**

As to sectors that are particularly hot or interesting right now, where we're seeing a lot of action, certainly wind and solar continue to be attractive and are attracting a lot of dollars into new technologies, biomass, waste-to-energy. We're seeing a lot of interest from our clients in new technologies in those sectors. As I said earlier, here in New York we see a lot of the less capital intensive technologies. Software technologies that are legacy I think to New York's history as an IT center.

**Are you seeing these initial rounds of funding being adequate to bring these new technologies to market, or at least to a point of proving their viability?**

Many of the renewable energy companies, for example, are very capital intensive investments and in addition to the technology investment they are going to need a whole new level of financing to get to that project stage -- get through that and prove their technology. That doesn't fit perfectly within the traditional venture model where once a technology that was proven, the company was successful and had revenues or the exit was there.

There is another layer on top of that it actually needs to be built out at a large scale project level in order to actually start realizing the revenues. Additional investment capital is needed

at that stage, but there is also the potential availability of tax breaks, DOE loan guarantees, potentially grant money that may fill that gap and allow those companies to prove out their technologies.

**Can you talk a little bit more about how these tax provisions can help fill those gaps?**

At the project level, tax credits play an important role in the planning and overall financing of the project. The DOE, I believe, has just extended their tax credit program for another year with respect to efficient vehicles, biomass, and certain other renewable energy sectors that will continue to make tax credits as an important part of the puzzle when it comes to putting their project together.

**Looking forward, what do you think lies ahead for the cleantech sector?**

In 2010, the cleantech sector, in particular renewable energy, will continue to be a very attractive and growing sector for investment dollars. We're going to continue to see a lot of technology innovation at the earlier stage. In large part, that may be spurred on by government regulations -- whether it be dollar incentive programs or regulations that just make the overall sector more attractive for growth for those companies and to encourage the growth and to move the country away from a dependence on old line energy sources.

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