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Mass High Tech

Cleantech-focused funds take over as general VCs back off cleantech

By Galen Moore

Did VCs all suddenly decide saving the environment is a bad idea?

In the late-to-middle portion of the last decade, amid fast-rising oil prices and expectations of regulatory changes, the energy sector followed telecom equipment as a chapter in the history of irrational VC exuberance. Like venture investing in every sector, VCs' cleantech investing dipped in 2009. Then, while other sectors recovered in 2010, cleantech stayed flat, according to the Cleantech Group, a San Francisco-based industry tracker.

But which firms stuck their necks out the furthest, and which pulled out the fastest? An analysis assembled for Mass High Tech by Dow Jones VentureSource shows 10 firms that made five or more new cleantech investments from 2003 through 2008, and then stopped doing new cleantech deals altogether.

The top firm on our list was @ventures, the Waltham and Palo Alto, Calif.-based venture arm of ModusLink Global Solutions Inc. (Nasdaq: MLNK), formerly CMGi. After doing nine new cleantech deals from 2003 to 2008, the firm has done zero since. Another Massachusetts firm, Atlas Venture, was tied for number five on our list — with several other VC firms that did about five cleantech investments from '03 to '08, then halted new investments. Neither firm could be reached for comment in this article.

New York VC firm RRE Ventures, which has been active in Boston in cleantech and other sectors, was also among the top 10. RRE hasn't changed its strategy, partner Stuart Ellman wrote in an email: the firm has always focused on demand-side deals like Boston-based Ember Corp. It's continuing to look for such deals, but, "our existing portfolio companies are dominating many of these spaces," Ellman wrote.

Many VCs appear to have found over-diversification to be a costly strategy. Firms that had historically focused on traditional VC sectors such as information technology and life sciences returned their focus there after the 2008 economic wakeup call.

While diversified firms pulled back, dedicated cleantech investment firms have stepped forward, said Peter Rothstein, president of the New England Clean Energy Council and a former investor at Flagship Ventures. They're small, and they're few, but they're doing more deals.

Black Coral Capital is one such firm that seems to tell the story of diversified funds' flagging pace in cleantech investing. In 2009, the New York- and Boston-based cleantech VC firm poached Rob Day from @ventures, which then quickly halted its pace of cleantech investing.

Day was on vacation, and unavailable for comment prior to deadline, but Black Coral vice president Nikhil Garg said that right now, with other institutional investors bowing out, deal flow is excellent. “There’s a whole host of companies that have gotten through a lot of early milestones and are making progress ... that are widely available at this point,” he said.

Black Coral is an atypical firm. Backed by a family office, they invest from an uncapped, or evergreen, fund. However, Garg said he fears that in 12 to 18 months, that well may run dry. “I’m not really sure where the next round of Series A companies will come up from,” he said. “It’s at the early stage that there’s a desperate need for capital.”

However, new seed groups are forming to fill that gap: Boston Cleantech Angels formed last year, joining the Clean Energy Venture Group, founded by David Miller in 2004. As of last fall co-founder Bic Stevens had said Boston Cleantech Angels has as many as 20 members. Stevens also runs Stevens Capital Advisors, a Boston-area cleantech investment banking and advisory firm, and was formerly a managing director at Zero Stage Capital.

New kinds of investors are also emerging as well — although not necessarily focused on early stage. Another Boston-focused cleantech fund, **WindSail Capital**, is brand new, and out raising capital now for secured notes on cleantech startup assets. (See sidebar.) **WindSail** is also evergreen, and structured more like a hedge fund than a traditional venture fund.

New kinds of investors in cleantech are exactly what is needed, said former Advanced Electron Beams CEO Mitch Tyson, who this month kicked off the Energy Leaders Forum, a joint effort between Mass High Tech and the NECEC.

Cleantech startup finance, he said, needs to look a lot more like biotech startup finance. Both have a long time to exit for early-stage investors, and huge capital requirements. And yet, no one talks about investors backing off of biotech. The sector has a more mature and diverse structure for bringing technology to market fruition, Tyson said, and cleantech can emulate that.

“I think the structure of investment in the biotech world is that there are intermediaries,” he said. “I don’t know that cleantech has developed that: investors to handle the early stage and investors to handle the later stage, (and) cash out the early stage.”

Rothstein said he agrees with that idea, and said even if cleantech doesn’t have a fixed framework for doing it, some companies have shown how it can be done. They start with government funding such as Advanced Research Project Agency - Energy (ARPA-E) grants, he said, then move to venture capital, and in the last, most capital-intensive stage, rely on strategic investors, overseas capital and private equity.

“You don’t just see typical venture capital taking it all the way,” he said. “Being able to connect the different parts of the capital supply chain is very important in this industry.”

Windsail makes cleantech debut

There’s a new cleantech fund investing in Boston. They weren’t mentioned on the press release with other co-investors, but last summer's $2.6 million funding round for Boston energy conservation startup Next Step Living Inc. was the inaugural deal for **WindSail Capital Group LLC**, a brand-new cleantech investor that is offering loans to cleantech companies with assets to show.

Founder Michael Rand, a former private equity middle market debt financier, said **WindSail** gave Next Step Living a loan secured by the company's receivables and inventory. Next Step installs home energy efficiency measures that are subsidized by government efficiency incentives.

"Traditional lenders are looking for things like financial statements, profitability," said Rand, whose last gig was evaluating consumer-company assets as a founding partner at GB Merchant Partners, a division of Gordon Brothers Group. "Next Step is a new company, growing dramatically. They weren't able to check those boxes and weren't able to get there."

WindSail is also doing distressed deals and loans on soft assets like intellectual property, Rand said. He is still fundraising. Investors to date — he declined to say who or how much — have been individuals, but Rand hopes to grow to attract institutions. Because it generates liquidity in the form of interest and fees, he says he's structuring **WindSail Capital** like a hedge fund, where limited partners can pull out money at any time.

"The way I approach the market is much more an old-school approach," Rand said, "which is, unless you're the Bloom Box (Bloom Energy) where you're going to attract hundreds of millions of dollars of VC, you need to be thinking much more in terms of trying to build a sustainable business."