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“Angel Investors” Fuel Green Ventures

PRIVATE EQUITY INVESTING IS GROWING IN POPULARITY IN THE FACE OF LACKLUSTER STOCK MARKET RETURNS; AND AFFLUENT INDIVIDUALS WHO ARE INTERESTED CAN CHOOSE A NUMBER OF AREAS IN WHICH TO INVEST, INCLUDING GREEN TECHNOLOGIES THAT WILL ADDRESS PROBLEMS LIKE GLOBAL WARMING.

Mindful of the uncertainties in a volatile stock market, an increasing number of affluent investors are turning their attention toward private investments—in particular, young companies developing green technologies. While affluent individuals can invest directly in start-ups on their own, most today are choosing to join groups of “angel investors,” the wealthy individuals who provide financing for early-stage ventures.

“Few people are making individual investments,” says Professor David Brophy, Director of the Center for Venture Capital and Private Equity Finance at the University of Michigan. “They are forming [angel investor] groups that are beginning to look like venture capital funds but with individual money.”

Interest in these early-stage companies is being driven by a number of social and economic factors, experts say. Concerns about the environment—including global climate change and dependence on foreign oil—are on the minds of many investors. But it is the increasing cost-effectiveness of new technologies that are making these attractive investments for angel investors.

“The interest level from angel groups in green start-ups is definitely increasing,” says Marianne Hudson, Executive Director of the Angel Capital Education Foundation in Kansas City, Missouri. “Angels are looking for good returns but a lot of them have multiple motivations

for being angels, including doing well by doing good.”

Much like venture funds, angel groups—which average 42 members each—conduct extensive due diligence on start-ups, which includes researching management and checking references. It also includes researching the underlying technologies. “The good news for individual investors is that most of the [green] technology is fairly easy to understand,” says Tracy Leteroff, Global Managing Partner of the venture capital practice at Price Waterhouse Coopers. “That isn’t true for many other technologies and the life sciences, where the science can be very challenging for a person without a technical background.”

Of course, no amount of research can eliminate all of the risks of investing in start-ups. As a result, following basic investment guidelines is important, according to Fred Wainwright, Executive Director of the Center for Private Equity and Entrepreneurship at Dartmouth’s Tuck School of Business. Wainwright recommends diversifying your risks by investing in 10 or more start-ups over a period of several years. You should also set aside an equal amount of money for future investments, since companies will usually need additional capital to fund further growth. “Angel investments can be an effective portfolio diversification strategy, and you can invest up to 10 percent of your overall portfolio in private companies without causing excess volatility,” Wainwright says.

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THE NUMBERS

The growth of green investing has been a relatively new phenomenon. In 2006, angel investors provided \$1.54 billion in the clean industrial and energy sector, according to a 2006 analysis report from the Center for Venture Research at the University of New Hampshire. That dollar figure represents 6 percent of all 2006 angel investments, a significant increase from the first half of 2005, when the category didn't warrant mention in the Center's report.

Angel investors should be watched closely, experts say, because they are often on the cutting edge of larger investment trends. “The angel market is essentially the spawning

ground for the next wave of high-growth investments,” reports the Center for Venture Research, and they may pave the way for a broader class of investors in the future.

Which green sectors are garnering the most interest? Biofuels, solar power, battery alternatives and clean burning coal technologies, according to Lefteroff. By contrast, wind technology is one of the promising technologies that have yet to emerge, he says.

RISKS AND REWARDS

Investments don't always translate into returns, of course, and some experts have drawn parallels between this so-called “watt.com” era and the dot.com years of the late 1990s. During that time, investors paid handsomely for promising companies that failed to live up to their potential and ultimately went out of business. This time around, a boom is definitely underway. For example, IPO values in energy technology were up 156 percent in 2006, driven by solar and biofuels.

So far, the public markets are also suggesting that green ventures have a promising future. The WilderHill Clean Energy Index—which currently tracks 43 publicly traded companies positioned to benefit from the transition to cleaner energy and conservation—has doubled since its December 2002 inception.¹

The Cleantech Report, published by New York-based advisory firm LuxResearch, sees

opportunities in clean air, water and waste technologies, which it says have received little of the capital flowing into the sector. Whether a bust will follow is anyone's guess, but the Cleantech Report raises the possibility that early investors may be left with little or nothing, if companies operating in these sectors fail to develop technologies that catch on with consumers. Investors can't be sure whether valuations are too high, however, until the products are commercially viable. “We may find that they were undervalued,” Lefteroff says. He also doesn't see strong similarities between recent interest in green start-ups and the Internet frenzy of the last decade. “We already know that there is huge demand for gasoline and electricity alternatives, if they work and are cost-effective.”

¹Bloomberg data through May 24, 2007.

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