

Third Quarter 2012

MARKET UPDATE

Energiewende

This quarter we have been blessed with numerous liquidity events in our VC and buyout funds (again), a fully functioning JOBS Act and more interesting developments in cleantech. We will touch upon each of these below.

Germany's Energiewende

Germany, the world's fourth-largest economy, has undertaken the monumental task of cutting its greenhouse gas emissions 40% from 1990 levels by 2020 and 80% by 2050. This is a grand experiment in one of the world's most industrialized economies, which will require switching its nuclear and coal energy infrastructure to renewables. This huge undertaking has become known as the Energiewende, which means energy transition. Germany's politicians are betting that their scientists, academics and industrialists can create the tech advances and infrastructure necessary to do this. If they are right, Germany will be able to export this technology to the rest of the world. If they are wrong, Germany's industries will suffer brownouts and blackouts and its economy will falter.

Germany created just 6% of its energy from wind, solar, hydro and biomass in 2000, but boosted that to 20% by last year. It must reach 35% to meet its first goal. Wind and solar installations of all sizes have sprung up across Germany in the last few years thanks to generous surcharges for renewables. Roughly half of these are privately- or community-owned, compared to roughly 2% in the U.S. Efforts are underway to use every technology available to meet these lofty goals. Energy efficiency programs are being undertaken in municipalities and manufacturing plants. Germany is looking to install wind turbines, inverters, DC transmission lines and energy storage capabilities at a scale never before achieved to develop its offshore wind potential. It will need to develop software and hardware capable of controlling what will amount to thousands of distributed generation sites to power everything from homes and schools to its heavy industries like auto manufacturing. It also will need to retrofit existing buildings to use less energy via better insulation, smart glass, and energy efficient lighting, HVAC and motors.

All of this would be impressive enough on its own, but in the wake of the Japanese nuclear disaster at Fukushima, Germany upped the difficulty factor by deciding to close its nuclear plants. The eight oldest plants were shut immediately last year; the remaining nine will be shut by 2022. Nuclear power provided about 23% of Germany's electricity. This means that Germany now must hit its emissions target without the benefit of its greatest source of fossil-fuel-free power.

Germany currently exports about \$12 billion of cleantech products to the world. If successful, Germany's cleantech exports will certainly rise and it will become energy independent. Viel Glück!

JOBS Act

In April, the Jumpstart Our Business Startups ("JOBS") Act became law. The primary purpose of the Act was to make it easier for small businesses and entrepreneurs to access capital. Much credit goes to the National Venture Capital Association for its

tireless efforts to get Washington, D.C. off the backs of the entrepreneurs/job creators and, in this particular case, cutting burdensome regulations on private capital markets and the IPO process. The Act primarily does the following:

1. Legalizes “crowdfunding” as it was naturally intended to be by providing exceptions to otherwise applicable securities laws (i.e., now anyone can invest potentially up to \$10,000 in a cool, high risk, and very early stage new gadget company vs. the old charitable donation/pre-order of a cool gadget if it ever comes to be with absolutely no investment return upside model ala Kickstarter);
2. Permits private equity firms to advertise that they are raising new funds so long as they only accept investments from accredited investors and comply with other regulations;
3. Permits private companies to remain un-registered with the SEC longer (moving the private-to-public threshold from 500 shareholders to 2,000 shareholders, albeit too late to help Facebook avoid registration);
4. Permits companies with less than \$1 billion in revenue to file for an IPO and solicit comments from SEC review staff outside of the public eye (note: Groupon could have used this to better resolve accounting matters with SEC staff prior to going public).

This latest “gift” from the elites in Washington will produce only modest job creation and economic growth but it is a step in the right direction. Crowdfunding sites like WeFunder, Startup Addict, Kickstarter and RocketHub are flourishing, thus funneling much needed capital to entrepreneurs. We believe dozens of privately funded companies have filed confidential registration statements with the SEC since the Act became law, including at least five of our own portfolio companies. Of those five, Trulia successfully completed its IPO already. We are monitoring the progress of the others and expect many more companies will follow in their footsteps.

Private Equity Exit Activity

Slow growth, high unemployment, regulatory uncertainty and fiscal deficits. Not exactly headlines you would expect to coincide with successful exits for private equity-backed companies, right? While a general feeling of anxiety continues to dominate the economy, we are seeing a steady stream of liquidity from private equity managers, both on the buyout and venture side. In fact, our Q2 distributions were some of the largest in our history and Q3 is on a similar pace as of this writing. Strategic acquirers continue to be particularly active on the M&A side, which we attribute to their solid balance sheets and (quite frankly) need to “buy” growth to meet their own top-line projections. Notable strategic acquisitions recently: Pirelli tires (acquired Däckia), Salesforce.com (Buddy Media), Valeant Pharmaceuticals (OraPharma), Thompson Reuters (FX Alliance & MarkMonitor) and Google (Meebo). Despite the Facebook IPO debacle, private equity IPO activity made a strong recovery. Trulia (NYSE: TRLA), Globus Medical (NYSE: GMED), Hyperion Therapeutics (Nasdaq: HPTX), Kayak Software (Nasdaq: KYAK), Five Below (Nasdaq: FIVE), WageWorks (NYSE: WAGE) and Splunk (Nasdaq: SPLK) all completed IPOs after Facebook’s offering.

The Latest on China

As you know, we have spent a significant amount of time and effort evaluating the Chinese private equity market over the last six years. Despite an amazing growth story and strong early returns from private investments in China, we remained cautious, dipping only a toe in the water. Our reasoning was based on a few key beliefs:

1. Investing privately in Chinese companies and immediately taking them public on U.S. exchanges was a fad/market anomaly;
2. Mere financial engineering without adding real value would be an unsustainable model in China, just as it had been in the U.S. and Europe;

3. Systemic regulatory issues and questionable business practices would create substantial problems for investors (e.g., government bias against foreign investors, limitations on repatriation of capital and (ahem) “non-western” accounting practices).

For a few years, China’s growth masked these issues. While real GDP growth in China remains impressive today (7.9%), it has subsided considerably (e.g., it was 10.4% in 2010 and 14.2% in 2007). Growth is no longer “easy” in China. As a result, private equity investors must actively manage their Chinese companies and inject real operational know-how in order to grow their companies and create strong returns. In addition, there has been a loss of confidence in Chinese listed companies among institutional investors in the U.S. and Europe. This loss of confidence has been driven in large part by the emergence of:

1. High-profile fraud cases (e.g., Longtop Financial and SinoForest);
2. Auditor resignations (18 resignations by the “Big 4” for U.S.-listed Chinese companies in 2011);
3. Heightened regulatory scrutiny (>30 investigations against Chinese companies in 2011 and approximately 30 Chinese companies have been delisted overseas or trading has been suspended/halted).

These issues have led to dreadful aftermarket performance of Chinese companies that conducted IPOs on the NYSE or NASDAQ since 2007 (nearly a 60% decline post-IPO). As a result, the IPO markets for Chinese companies are nearly closed. We don’t foresee a change until the systemic issues are addressed. Further, the geopolitical trends seem to be going in the wrong direction at the moment. For more commentary, please also see our May-June 2008, Q4 2010 and Q2 2012 commentaries on China, which are available on our website ([Market Update Library](#)).

Quote of the Quarter

[Speaking to European distressed fund managers] “The stuff you want to buy, those banks ain’t selling; the stuff they are selling, you don’t want to buy.”

– Anonymous U.S. distressed investor

Scott Barrington’s Interview for Sustainable Alpha

Scott Barrington was recently interviewed for the Portland Business Journal to discuss the global trends in ESG investing. His conversation with writer John Wrenn was featured in their Sustainable Alpha section, which highlights best minds, portfolio managers and industry leaders working to maximize returns while prioritizing environment, social and governance factors. To read Scott’s interview, click [here](#).

Staff Promotions

We are pleased to announce the promotions of Tom Jorgensen and Brennan Plaetzer to Associates. Tom and Brennan both joined the firm in 2010 as Analysts on our investment team, working with senior members of the team in all aspects of investment analysis and reporting. Congratulations to Tom and Brennan.

Upcoming Events

We are regular speakers and attendees at key industry conferences. We hope to see you at these upcoming conferences:

October 2-4	SRI Conference, Uncasville, CT www.sriconference.com
October 8-10	Nat'l Coordinating Committee for Multiemployer Plans, Hollywood, FL
October 22-24	FOX Fall Forum, Chicago www.familyoffice.com
October 24	Wells Fargo Social Impact Private Client Event, Menlo Park, CA www.wellsfargo.com
October 24-25	Quebec City Conference, Quebec www.quebeccityconference.com
November 11-14	58 th Annual IFEBP Conference, San Diego www.ifebp.org
November 14-15	Texas Buyouts, Dallas www.buyoutsconferences.com

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