Starfish Ventures

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Jillian Broadbent, Chair
CEFC Expert Review
cefc@treasury.gov.au

CEFC Request for Submissions

Dear Ms Broadbent

Thank you for your invitation to make a submission to the Clean Energy Finance Corporation ("CEFC") Expert Review.

Starfish Ventures was established in 2001. It is an Australian owned venture capital fund manager focused on active investment in innovative Australian technology companies. Starfish Ventures has over $400 million in funds under management and has made investments in over 40 companies. It invests across all technology sectors including information technology, life sciences, and cleantech, of which a large fraction comprise energy technologies that would fall within the scope of the CEFC.

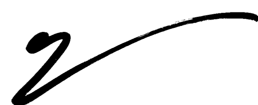
Starfish Ventures' seven investment professionals have backgrounds that include venture capital investing and starting and managing small technology companies, including in the renewable energy sector. Our investment history includes companies such as ResMed (NYSE), Ausra (large scale solar thermal firm acquired by Areva SA) and Energy Response (energy demand management company acquired by Enernoc, Inc).

The attachment provides an answer to each of your questions. In summary, our most important recommendations are:

- The CEFC should outsource its investment functions to external fund managers or professional advisors;
- That the CEFC should support a portfolio of technologies in all areas that it is targeting; and
- The most persistent funding gaps we see are in early stage technologies and low risk, low upside projects that aren't sufficiently demonstrated in Australia.

We would be pleased to answer any questions relating to our submission or to work with you to shape the CEFC so that it has the greatest possible impact in commercialising and deploying renewable energy, energy efficiency and low emissions technologies.

Best regards



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1. How do you expect the CEFC to facilitate investment?

a. Setting appropriate investment mandates including amounts, appropriate time frames and justification for each area that is perceived to lack sufficient investment. The CEFC should avoid financing projects that would be commercially financed anyway (for example wind farms that would be built as the cheapest way to fulfil the RET). It should also avoid financing speculative technologies that are unlikely to be commercially viable within a reasonable timeframe. The areas in between—the legitimate focus of the CEFC—should be debated and subject to public comment.

b. Once the detailed investment directions are determined, an appropriate external party should be solicited and mandated. In some cases new entities will need to be established or overseas firms or individuals will need to be enticed to Australia. This could occur by:

   i. Fitting into a manager's or fund's pre-existing investment goals;
   ii. Working with a manager to adapt its mandate to a particular objective; or
   iii. Working with a manager to create a specific pooled fund or investment activity to meet the mandate. This could be by a process similar to the REVC whereby proposals for specific investment objectives were solicited from managers, or it could be more directive (for example, "invest up to $50M annually in projects that meet XYZ characteristics").

c. In all cases private matching funds should be required, and the managers would be responsible for sourcing them. However, the degree of matching, the type of instruments used and the priority of capital could vary dramatically according to type of investment.

d. Independence from the government demands of the day is important so that investment objectives remain stable over time.

e. The location of the CEFC is important to gaining independence, hiring suitably qualified staff and building relationships with institutional investors. The majority of superannuation funds are in Melbourne and there is a critical mass of financial services in Sydney. They are the most suitable choices.

2. Are there principles beyond financial viability that could be used to prioritise investments, such as emissions impact or demonstration affect?

Yes.

If financial viability were the only criterion, the CEFC's funds would be competing with private capital. This is important and the overarching principle ought to be that the investment aids in the transition to a lower carbon intensity economy. The detailed objectives need to be set within a broader policy framework. Our suggestions are:

a. Ensure a portfolio of renewable energy generation, energy efficiency and low emissions technologies. We don't yet know which technologies will end up in

Australia's mix of commercially viable technologies, so a number ought to be supported. However, those that are highly unlikely to be commercially viable in a reasonable time-frame ought to be excluded. There are several reasons that a technology may not be funded commercially, although it is commercially viable, or nearly so:

i. It is not the cheapest technology, but may be in the future (eg solar thermal or wave generation relative to wind). In this case a financing subsidy (low interest loan, guarantee, first loss, etc) is required;
ii. It is commercially viable elsewhere but not in Australia because the financing community has not seen it before. In this case demonstrations would be valuable (with the CEFC supporting a targeted number of projects with similar characteristics);
iii. Projects are too small to support the transaction costs. The CEFC may subsidize project aggregation. Over time, transaction costs should fall; or
iv. Accelerate capital investment that would otherwise occur later (for example an energy efficiency upgrade).

b. Coordinate with industry policy. For example, remote area geothermal energy requires a transmission grid to a location with energy needs. If policies don't exist to build the transmission lines (likely beyond the scope of the CEFC), the CEFC should not help finance the development of the geothermal energy source. Similarly, supporting fuel switching at a coal-based power station makes little sense as long as it is government policy to continue to operate the coal operation of the plant.

c. In certain cases the CEFC may determine non-viable investments are in the interest of achieving its overarching goals. Subsidizing early stage investments may be one such instance.

3. What are the opportunities for the CEFC to partner with other organisations to deliver its objectives?

CEFC should focus on setting mandates and soliciting, managing and overseeing external managers that will carry out the investment activity and private fundraising.

4. How could the CEFC catalyse the flow of funds from financial institutions?

Essentially the CEFC is providing a financing subsidy to enable projects that are not otherwise commercially viable at a particular point in time. The CEFC should have access to the full range of financial products including:

- Equity (ordinary, preferred, first loss)
- Debt (senior, mezzanine, junior, convertible)
- Hybrid/structured financings
- Loan guarantees (repayment of principal & interest by borrowers)
- Refinancing guarantees
- Co-underwriting debt syndicates

In all cases, we recommend working through external managers or arrangers.

5. What experiences have firms in the clean energy sector had with trying to obtain finance; have term, cost or availability of funds been the inhibitor?

Term, cost and availability are all related. We have seen all occur. Some examples:

- Waste to energy projects are relatively low risk but typically offer a return of only 10-20% annually, have little or no upside and have relatively high transaction costs. There is no provider of capital at these return rates (need demonstration financing to be subsidized) and transaction costs need to fall (could be achieved by aggregation and demonstration). These rates of return (particularly at the upper end) will be very attractive once conservative investors appreciate the low risk;

- Ocean power technologies are perhaps a decade from commercial viability. This time frame is too long for venture capital, the only form of financing that could tolerate the current risk of these projects. Furthermore, there is follow-on financing risk, since the future state of the capital markets can't be accurately forecast. The CEFC could ameliorate this by guaranteeing a percentage (perhaps half) of a future financing if all milestones were achieved; and

- Early stage renewable energy technologies are currently mostly not being funded because there are few funds with a high risk mandate. Although the CEFC needs to take care not to waste its capital, early stage investments cost little in aggregate and without them there won't be any Australian technology companies at a late stage. The REVC will partially ameliorate this, but won't do so sufficiently since it will only fund one manager.

6. What non-financial factors inhibit clean energy projects?

- Government policy. Stability around regulatory regimes is critical (eg the RET, carbon scheme and solar subsidies). The rules of the energy markets and regulation of the players within it also have a huge effect on renewable energy access, deployment of smart grid technologies and the ability of businesses to profit from improving efficiency or peak load reduction.

- Among small companies, management teams are almost universally weak. Australia has trouble attracting talent to this sector of the market. This is improving slowly, but the CEFC could help in this respect by:
    - Providing positive press to companies in the sector;
    - Underwriting management scholarships or top-up compensation (existing examples are the NREL executive program in the US or the Federation Fellows program in Australian academia); or
    - Subsidizing the repatriation of Australians from overseas.

7. Are there special factors that inhibit energy efficiency projects?

Yes.

- Management focus and priority ("yes, changing light bulbs has a 1 year payback, but who cares about such tiny savings?");

- The projects are often small with a high transaction/management overhead;
- Split incentives between asset owners that pay for projects and lessees that benefit (eg landlord-tenant);
- Asset life issues: assets typically aren't replaced until they have reached the end of their planned lives and are fully depreciated;
- Lack of education and awareness. Business owners or decision-makers often aren't aware of the cost savings they could achieve because energy cost isn't the primary focus of the business.

8. How do you see the CEFC fitting with other government initiatives on clean energy?

We see ARENA as being the main vehicle for direct investment (grant) support and highly specific programs. It is a direct instrument of government policy, whereas CEFC has a relatively broad mandate and would typically work with external managers. The two are complementary, in that an entity receiving ARENA funds could still be eligible for CEFC subsidized finance as long as it met CEFC's criteria.

The RET is attempting to achieve a subset of the goals of the CEFC. We believe that any project that would be commercially financeable with RECs alone should not be eligible for CEFC funding. However, the receipt of CEFC assisted financing should not disqualify a project from receiving RECs.