diffuse*tap*
Virtual Event Series

Compounding Impact in Climate Tech

Guest Speakers:

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Tony Zhu
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DiffuseTap: Compounding Impact in Climate Tech

Last time on DiffuseTap, Paul Seidler and Tony Zhu from Clean Energy Trust talked to us about how a public charity-structured venture fund works, what "compounding impact" means, and funding early-stage climate tech and cleantech startups at the right time to create maximum impact.

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DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas) … straight from your armchair like a boss.

Meet the Speakers

PAUL SEIDLER is a serial problem solver who helps early-stage companies develop and deploy innovative clean energy solutions. He is currently the Managing Director of Clean Energy Trust, a nonprofit fund that invests in early-stage startups with tremendous potential to lead the transformation to a sustainable, zero-carbon economy. LinkedIn: @paul-seidler

TONY ZHU is passionate about early-stage climate technologies that aim to reduce dependence on carbon-centric societal structures. Tony is the Venture Associate of Clean Energy Trust, where he works with entrepreneurs and startups that seek to revolutionize the climate paradigm. Linkedin: @tonyzhu1

About Diffuse

We are an alternative fund platform offering differentiated investment products. From digital assets to VC funds and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information, visit www.diffusefunds.com.

KENNY ESTES: Today's speakers are Paul Seidler and Tony Zhu. Paul, do you want to briefly introduce yourself?

PAUL SEIDLER: I'm Paul Seidler, very nice to meet everyone today. I'm Managing Director at Clean Energy Trust. We are an early-stage fund based in Chicago. I won't jump into the juicy details yet. I'll hand it off to my colleague Tony to do a quick intro on himself, and then we can get into the details.

TONY ZHU: Thanks, Paul. Hi, everyone, nice to meet you all. Tony Zhu, Venture Associate at Clean Energy Trust. I lead due diligence for new investments, and I work with Paul on portfolio management.

AYLA KREMB: Beautiful. Thanks so much for coming. Maybe we'll start off with the most interesting bit, which is how you've actually structured your fund. You're not a standard VC fund. How do you make investments?

PAUL: Yeah. So Diffuse's interest is in alternative assets, and it doesn't get any more alternative than this. We are a seed stage venture fund focused on climate tech and cleantech at the very earliest stages. Our structure is an investment model that we describe as a 501vc . Those of you who are even loosely familiar with the U.S. tax code will know that a 501(c)(3) organization is a tax exempt organization that is either a public charity or a private foundation. We are structured as a public charity.

Our 501 VC investment fund is exactly what it sounds like. It's a seed stage venture fund structured as a non-profit. So, why are we structured this way? We're structured this way very intentionally. It gives us the ability to bear a little more risk than the market, which gives us the ability to invest in very early-stage technologies that otherwise might not get the funding they needed to commercialize. We don't have LPs, we have donors.

Our fund is capitalized with philanthropic dollars, and structured as a revolving evergreen fund. So, any returns we see from our investments get recycled back into the fund and redeployed. This is the way we describe the mechanism, as it's really key to our pitch to donors. It's a concept we refer to as compounding impact. While a lot of nonprofits talk about what percentage of donations get put to work towards the mission, we like to think that there is no ceiling. It's not up to 100%. It can be over 100%, kind of like fusion energy, where you put in a certain amount of energy, and you get more than 100% out.

This is compounding impact in the sense that if we make enough of the right bets over enough time, then the fund can self-sustain and grow on its own. To date, we've invested in 37 climate tech startups. We're focused regionally in the broader Midwest region of the US. We've had four exits so far, where we had profitable returns recycled back into the fund and redeployed. In total, we've had a little less than a million dollars in capital that was recycled so far. To date, we've invested $6.1 million into 37 companies. The average check size these days is usually $200,000 to $300,000. Sometimes less, sometimes more. I will pause there in terms of the overall fund structure.

TONY: I think you hit it all. That's a good summary.

KENNY: Okay, that is fascinating. That's a very detailed answer. A lot of the audience here are just starting out, and in most cases, VC funds typically do 2 and 20. How do you set up your fees for this fund vehicle as it is a nonprofit? Does that look different as well?

PAUL: Yeah, that's a very good question, Kenny. An important point to consider is that this structure allows us to actually divorce ourselves from the 2 and 20 model. That's important. There are people that have raised small microfunds, but it's hard to have sufficient resources to run that fund, with two and a half percent, or sometimes even a little more for really small funds. It's not a lot of money.

And oftentimes, you hear from venture funds a rule of thumb of one partner per $50 million. Well, what are you gonna do if you have a $10 million fund? It's hard to really have a back office and all that. So, we completely separate ourselves from that model. As a nonprofit, we go out and we get grants from government agencies, foundations, corporate partners, etc. Some donors want to donate their money to the fund. Some donors don't want to donate their money to the fund, and they donate it to our operational budget. So, they're completely separate. That allows us to have a team of eight.

Not everybody is totally focused on the investment fund. That's more Tony, myself, and one of our other colleagues. But we do get involved in other things in being a nonprofit, just generally supporting the entrepreneurial ecosystem. Does that answer the question?

AYLA: It does, absolutely. One of the bits that we think will be really worth diving into is, what kind of companies do you invest in? I know that primarily, it’s climate tech and early stage, but how did you choose a specific vertical? And what makes early-stage climate tech companies a particularly good fit for this kind of investment model?

TONY: We invest across the broad spectrum of climate tech. We view it as a very diverse space where a lot of different opportunities can generate different kinds of impact. And we're well suited to invest in most of those companies. We're looking at companies that have some sort of long-term climate impact or sustainability impact, specifically in the pre seed to series A stage. And we have a slight preference towards hard tech and deep tech companies. We also focus on the greater Midwest region, from Denver to Pittsburgh, to address the market failure that exists in this geography where incredible founders and much-needed innovations in the Midwest are chronically unable to raise as much funding as their peers can on the East or West coasts.

Generally speaking, our model is well suited to support companies that might take longer time horizons to commercialize. I noticed there was a question in the chat about commercialization. I wouldn't say that we're necessarily targeting companies that specifically have longer than X number of years to commercialize. Our model is suited to support some of those companies with really game changing innovations that, in most cases, take a lot of time and take a lot of money to commercialize.

Often, we're there as the first external investor in that company, to help them think strategically about how they want to raise funds going forward, and how they want to tackle the market. And a lot of times, traditional VC investors are beholden to time horizon constraints from their LPs, and they're not allowed, or they're not able to address some of the companies in this market.

KENNY: Maybe a follow up question for you, Tony. Given that you're doing this longer-term investing, the LPs want to see something, right? So how do you say to them "hey, there's this climate check thing, and we're going to be piling money into it for the next 10 years, but it may or may not work"? What do you show them in terms of reporting, or KPIs or metrics that make them comfortable that this is actually moving the needle, and that they should continue to support you?

TONY: Yeah, so one of the things that we track is job creation. We're looking at impacts, both from a climate perspective, and also drawing people into the industry as a whole. Our portfolio over the past couple of years has created over 700 jobs. That's one metric that we like to show in terms of impacts. We like to bring up success stories every now and then.

And we don't see ourselves as an R&D research institution that's equipped to granularly track the progress of how many tons of Co2 are abated exactly by each company, or how many gallons of water are saved. Some of those metrics are easier to measure than others, but we're not there to really get into the weeds with that. If we think of our companies as vehicles for climate impact, we like to see ourselves as the GPS, rather than the odometer for tracking that impact.

We help our portfolio companies get to where they want to be, in terms of their business model and their impact. And then along the way, we have success stories that come out of that. In our portfolio specifically, we've had four successful exits, with a couple more brewing.

Those are the types of case studies that we like to communicate to our stakeholders. We like to show them that as the funds come out of these exits, we re-inject that into the fund and reinvest in X number of startups. In fact, back to the question about compounding impact, every dollar that's invested from our donors gets magnified every time the dollar comes back out in the form of exit proceeds.

AYLA: Speaking to that piece about magnifying each dollar, does it also mean that the exit timeline is a bit long because you're adding on that early-stage period where you start deploying capital, and it'll end up as 10 or 12 years, instead of the original eight-year exit? I do remember that you mentioned the fund will most likely be sustainable at the eight-year mark, so it would be interesting to understand what the exit timeline is for the companies that you work with.

PAUL: Yeah. We're tracking it as it happens. We've been investing since 2014, so our oldest investments are seven to eight years old now. And certainly, several companies that are still growing and operating haven't exited yet or haven't shut down. So, the exact number is to be determined. We think our model is eight years, but we're probably underestimating it even at eight. But our model affords us to be inherently patient capital. We are very market driven.

We're looking for venture type multiples. But because we're less time sensitive, because we don't have LPs to return the money to within a certain amount of time, we can be less sensitive in terms of IRR. So, we're looking for the same type of multiples, whether it's 3 to 5x across the fund, or 10 to 30x on individual deals. We can absorb years even, at the front end.

Ideally, what we're doing is we're working with our portfolio companies to de-risk them to the point that traditional institutional venture investors are ready to come on board with larger checks. Our checks alone obviously are not going to be nearly enough to fully finance the companies' operations. So the question is, how long will that take?

Sometimes it could be six months. Sometimes it could be three to four years of people in a laboratory developing the technology before institutional investors are ready to write that larger check. But yes, we can absorb those few years. It's going to crush our IRR, but who cares? Our model allows us not to worry about that. We can go for the 10x return in 10 years, instead of the 10x return in five years and still feel like we've done a good job as early-stage investors.

KENNY: Makes sense. So, how does that end? This is a question from Sebastian. How does that factor in with compounding? Because if you're coming in at the early stage, if your company is now in series G, then you can make an argument that you're adding a ton of value. Do you look at recycling that capital through the secondary market so you can come out more aggressively and get it back out? What are your thoughts around that?

PAUL: Yeah. I mean, we're flexible. If there's an opportunity for a later investor looking to clean up the cap table, as they say, and the company is going to be in a good position to move forward, then sure, we'll take the money back to market and recycle it. But it's not necessarily part of our production strategy. We're expecting to form lifelong partnerships with these companies to the point of exit.

AYLA: Given the conversation around secondaries where there might be more capital coming into the fund, you did mention at one point that you're always looking for more donors. What does that process look like? How do you find new donors that could be a good fit for your model? Is it the same people again and again, without family offices or foundations? How does it work so that you can keep fueling these companies that you're working with?

PAUL: Yes. We're constantly fundraising. I have a fun job in the organization. I obnoxiously say that our CEO and our director of development go out and raise the money, and then Tony and I spend it. I would much rather be on this side of the table. But yes, we're constantly fundraising. It can come from family offices, corporates, foundations, government grants, etc.

We can't offer any special deal flow to donors. There's no pay-to-play opportunity here. That said, our donors do see us as valuable partners in terms of building the pipeline. Investors might see value in donating to us and that we're building a pipeline. It's just that we're not building a proprietary pipeline for them. But certainly, any and all of our companies with follow-on investment opportunities are available to any and all investors there.

AYLA: Okay. Michael Gale just found your donation link online, posted it in the chat and made a donation. Anybody else who feels like it, go for it.

PAUL: Thank you so much. (Editor's note: To donate, go to cleanenergytrust.org/donate/.)

KENNY: I love it. For a regular VC with all the accreditation checks and everything like that, I'm guessing you don't even necessarily have to have a minimum for donations, right? It's just absolutely fascinating how you can really do that. That is something that I have not run across before. I have a question. You touched on it already, but I'll go back to it for one Mr. Steve Gold. At what point do you stop putting more capital into a company? Is it around series A and beyond? Is it more to your point about how you can be the best partner? Do you have hard cut offs? What does that look like?

PAUL: We really try to figure out where our money makes a real difference. For the most part, we're just doing our first check, and we're typically not following on. Because oftentimes, with the resources we have, we feel like it makes more sense for us to put any funding we have into these very early stage pre seed companies if it's at a time where we happen to have a little more dry powder, and there's an opportunity for us to catalyze a follow-on round, or maybe they're looking to raise a series A and our participation would be meaningful in catalyzing other investors.

There will be times that we will participate in a follow-on round, but for the most part, we're trying to allocate all our resources to that very early, earliest check stage.

KENNY: Tony, anything you want to add to that?

TONY: I would just say that we're looking to do what's best for our portfolio companies. And depending on what stage we get involved with, how that translates into where we can add value as an advisor or a board observer or anything like that, we'll stay on as long, and we'll keep on contributing as long as it's appropriate for the company.

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Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

Sharing his decades-long expertise on corporate governance, Dennis discussed how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. Read on

Susan Brazer
CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan talked about the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. Read on

Raj Mukherjee J.D.
VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for Coinbase and Binance from scratch, and how investors can profit from crypto without getting caught in a taxation mess. Read on

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