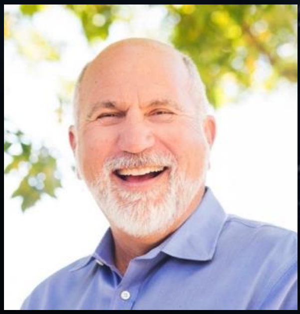
diffusetap
Virtual Event Series

Impact Investing Reimagined



Guest Speaker:

Tony Arnerich

Managing Director
3x5 Partners

Hosts:

Kenny Estes
CEO and Founder
Diffuse

Ayla Kremb
Chief of Staff
Diffuse

DiffuseTap: Impact Investing Reimagined

Last time on DiffuseTap, we featured Tony Arnerich, Managing Director at 3x5 Partners and former CEO of Arnerich Massena. During the session, Tony illustrated the true power of impact investing by discussing the opportunities available today, to help steer the world towards a more sustainable future.

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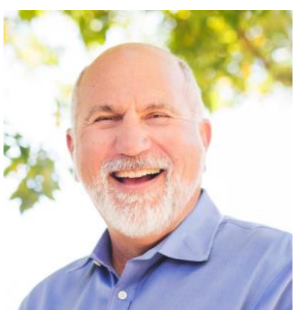
DiffuseTap

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 Speaker



Tony Arnerich has more than 30 years of consulting, private equity, and financial experience. He founded Arnerich Massena in 1991 to be a source of independent investment advice. He served at the firm as CEO for more than 25 years up until his recent retirement. Today, on top of sitting on the Boards of multiple companies, he focuses his efforts on leading the VC firm 3x5 partners as Managing Director. Linkedin: @tony-arnerich-8469586

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: Tony, thanks for being here. I'm really bad at introductions, so if it's okay, I'm gonna hand it over to you to introduce yourself.

TONY ARNERICH: Well, hello, everyone. Welcome to the crazy world of 2021 and venture capital investing. I'm Tony Arnerich. I've had a really wonderful career. I'm primarily a father and proud husband of a wife of 40 years, with five children and 11 grandkids. And you know that whole part of my life is pretty robust. I just retired from Arnerich Massena, which is a very large investment advisory firm in Portland, Oregon. And now I'm pretty much focused on 3x5 Partners.

So, my history is one of investing. I have morphed into a career of impact investing over 20 years ago, where impact made so much sense if you have grandchildren because you are worried about their future. I worry about the future of Mother Earth as a fundamental issue.

There's a reason why wind turbines don't work in Texas but work in Quebec and North Dakota. It's because Texas is crazy, and the reality of it is that, with impact, there's all kinds of - what would you call it - myths or weird things, or fad? Or is it, tree huggers? Or whatever.

I won't spend too much time talking about where I came from. But if you think, really simply, in life, what we do as venture capitalists is invest in companies that provide the solutions to the unintended consequences of global population growth, period. All of the other stuff is nonsense that the consulting industry wants to measure, when there's nothing to measure. The consulting industry wants to find out your carbon imprint when, my God, you're just starting as a business. You're worried about getting going. The market wants to codify and put into a consulting format a really nice report that is full of babble that doesn't matter.

What matters is that we get capital to those companies that can provide these big solutions. You're seeing electric vehicles, you're seeing battery, which is a hot thing. But we forget that before batteries, we have to have transmission. If we don't have electrical transmission, we don't have any kind of game at all. So, what's happening out there is that the traditional stuff that gets everything going, and everybody focused in one area but, well, all the time there are other more impactful areas. And not to say that electrification of vehicles isn't important, but without a complete and total redo of our transmission and distribution system, it doesn't work, folks. It just doesn't work.

So, electricity, the power of our whole economy, is probably the most misunderstood arena. The goal is to find these gems of ideas, and then provide the capital that they require, then build the syndicate and then bring them to fruition either in an EBITDA positive cash flow business, either in a trade sale, or in an IPO, or right now the specification of the market.

And everybody's gonna have their opinion about SPACs. My opinion about SPACs is, it's the best thing that ever happened to an early-stage venture capitalist, let me tell you. You better pay attention. So right now, all venture capitalists who have built businesses over the last decade or so are having an enormous opportunity to SPACify.

But really, when you really get down to it, it's just good old fashioned investment. It's getting a group of people together with some capital, finding a world class CEO, driving inclusivity and diversity into the board into the capital structure - that is an ongoing struggle. But we're successful, because you have to be intentional, and then you have to be purposeful. And then you have to be bold, like us, and be urgent to get it done.

So, you know, that's what I think about the area of impact investing. What we need is policy with tax incentives and let capitalism work. And I'm highly confident we in America will be the drivers of the change of behavior and directionality that allow potentially Mother Earth to breathe again. What happened in Texas had nothing to do with anything other than climate changing on the margin.

And we're gonna see it more and more and more and more, because the degradation of Mother Earth has begun, and I hope to God, we can be urgent and fix it. Because the net ramifications of us not fixing it, all you people who are working with capital and trying to make change are not getting results that matter in the long run. Pretty much history speaks loudly at these levels at these points of inflection.

So, you got to go out and do it. And it's really hard. I mean, we were very fortunate we had a captive asset base. Our path to success at 3x5 was because of our niche Massena, so I didn't have to do what you have to do. I had to do it a long time ago and build a big $40 billion advisory business, but that was where the capital came from.

And so, we had captive capital, which was a very long-term capital to boot, because it was a high-net-worth family business. So, to me, it’s just getting out there and doing it, and then hooking up with the right people. Because there's so many concepts out there, there're so many great ideas; but it's not that simple to take a great idea and build a big business.

At 3x5, you know, venture capitalism is a funny business. I think if you guys have been in this for any length of time, sometimes you invest a little bit of money in a company, and somebody wants to buy it, but sometimes you get there way longer. I mean, there's not a perfect storyboard that goes along to be a successful venture capitalist. But if we don't do this, I don't think there will be capitalism as we know it.

KENNY: That's really great. I'm gonna get to the questions, and I know this is going to be a really fun and lively session. He started us off on exactly the right foot. So, thank you very much for that introduction there. So, my partner in crime over here is Ayla Kremb, and we’re gonna tag team the tap dance, fireside chat, whatever we're calling it. So, Ayla, do you want to take away the first question?

AYLA KREMB: Yeah, I'm happy to. So, one of the bits you already touched on a little bit was the importance of having the right partners in place to help some of these impact businesses grow. Could you speak a little bit on how to identify someone to partner with? How to identify a good partner for an impact business?

TONY: Well, I think it's the same, really, regardless if it’s impact or whatever. It's always the same partnership thing. However, we've taken a different approach. So, if we're going to do an A round, we're probably going to do it ourselves. And the reason being is it's such a brain-dead activity for a young CEO to go out and try to raise in a round. I mean, you're going to spend 99% of your time with junior analysts that aren't going to give you a penny, and then you're going to wake up one morning and not be funded despite putting all this effort in.

So, getting the partners really takes some time. The reason that we are so concentrated and so large and have such large holdings is because of the failure of the venture capital industry. We have been on boards and in situations where I'm highly confident that venture capital investors are not able to roll up their sleeves and work through the problems, from identification to solution.

That's what they do, guys. I mean, I've worked with so many of them for so long, that these guys that are supposedly the gurus of investing, when really, you look at the track record, and they're really more like dogs and fire hydrants. They're gonna make their mark on every fire hydrant, hoping that one has something exciting in it.

And when you do the analysis from the other side, the other VC side, and you actually break down a fund and you look at what they do and how they do it, I'm not sure very many people would invest in these big blue-chip names who make a lot of money, because their hit ratio could be 10 to 20 percent. And, you know, we just can't lose 80% of our money to make 20%. It just doesn't make sense for us to have any less.

So, the partnership thing has been honed over 30 years of relationships. It's about relationships. And so, what we did is through trial and error, we found out who were the trustworthy? Who were the people who would last a long time? Who were the people who really could add value over and above capital?

KENNY: And that's a good segue. Because it is a relationship game, as you say. It’s just, a lot of experience, honestly, is made up of just building those relationships. But with your strategy right now, what are the - as they call it - the niches to riches? What are the niches in your sector that you're most excited about? You touched on electric cars a little bit, but you didn't seem to find that overly compelling. So where are you most excited right now?

TONY: Oh, gosh, I'm the most excited person in the world. Health care, it's gonna go through another major change, guys. We have to change healthcare technology, and the internet, and Zoom, and telemedicine. Telemedicine in mental health is the most exciting part. (We also covered healthcare investment in a recent DiffuseTap.)

For me, I think that in healthcare, to give you an idea of what I think is happening, is that we have reached a point where the diagnostics on the therapy side are gonna cure quite a few of our major illnesses, and at the same time is going to make healthcare more efficient. So, you got to be really excited about the two areas in healthcare.

Besides the tech, besides the billing, besides the software and all of those important things, I think that the transformation of healthcare in two areas, the gut and the brain, are the frontiers of medicine. The reason for the gut is, unfortunately, it's difficult. But for the brain, there's not really a good reimbursement unless you get a craniotomy or something.

But for mental health related issues, I think there's an enormous opportunity we have in mental health startups. I'm pretty passionate about mental health because it's the scourge of our system. Also, in solutions on things like Zero Mass Water Source, where we're taking a nascent hydro panel and capitalizing the company, and then building the first net new supply of water, which is quite fascinating in its applications and those kinds of things.

So, anything in that resource area. Another is we're looking at a company that replaces the glass in your cars with plastic. I mean, glass can be really very fragile and dangerous, so they're trying to solve that. You got to find stuff like that, where you're kind of trading one problem for another problem, but the net result is better. So, you're seeing a lot of material, you're seeing a lot of chemical, you're seeing a lot of water related deals. We like water a lot. We probably own more water than most. (Check out 3x5 Partners' portfolio here.)

So, anything in water, anything in healthcare, and then energy. Also, obviously, food and protein. We're after protein. Wild protein. We own a big fish company, and it's a pain in the ass business, but it's a lovely piece of protein that we're still subsidizing.

AYLA: What you just mentioned, a couple of them really teed up nicely to the audience, and we are getting bombarded with questions here in the chat, which is exciting. I love when the audience is engaged. We have a couple of questions specifically on emerging economies, in terms of when it comes to impact investing. What kinds of areas do you love investing in? Of course, you know, the US is obviously one, but we do know a lot of impact investors go to Africa, Asia, etc. Which emerging economies do you think are especially interesting and why?

TONY: Well, I think they're all interesting, because they're all wonderful people. If you're a people person, you're going to love emerging markets, because that's where it's happening. But specifically, it's tough for a Portland Oregon-based VC firm to be very relevant in Africa or Asia, or other places. So most of our work is done with companies that have an international reach. In other words, they will either get there, or start there.

But I think the emerging market economies have what I call a "wind to their back," rather than wind to your face. Wind to your back is, I think, a good thing for investors to get where you have a theme that's kind of pushing you forward.

So that's kind of how we look at the emerging markets, not specifically anywhere. I do speak three different languages. I could speak Spanish, Croatian, and English. And I would have to get down to meet the people to understand. And so therefore, my own personal time isn't as robust. But if I were younger, that's where I would go. I'll go to Colombia, to be honest. Those Colombianos muy buenos, you know. I mean, I would go somewhere where it was happening. I love the emerging markets. I think it's where it's going to be, economically, in the next 25 years. But specifically, I don't necessarily focus somewhereto make money and make a change.

KENNY: Love it. One of the questions is a bit of a segue, but to go back to your earlier comment – this is from Will Hogan, and it's very to the point – a lot of founders feel that VCs are hostile, right? Like, they think it's more of a "you win, I lose" sort of situation. So, how do you view that? How do you set yourself apart from those types when you're interacting with the entrepreneurs? Do you have more of a collaborative approach? And what are some of the key differentiators of your strategy, your approach in how you build those relationships, versus a more standard VC that's like, "I'm gonna show up to the director meeting after getting off my private jet and just tell you what to do."

TONY: Okay. First of all, realize that there's founder-itis. If you're a venture capitalist, please start with founder-itis. Founder-itis is a wonderful thing, and a dangerous thing. It's a wonderful thing because without the entrepreneur, we have no place to put money. So, you have to respect the entrepreneur, the founder. You have to enter your relationships with respect and realize that one in 100 founders bring their company from start to finish. And intellectually going in, the chances of that particular individual to be part of what it is at the end is very, very rare. My whole gig in life is "don't fight the odds."

Now, if you can find skills that they can use and not be too destructive internally, that's a really good situation. We have a couple where the founders are still employed, but not as CEOs, but maybe as Chief Technical Officer. If they have other skills, what you try to do is you try to work with them, because they have a culture, and they have an impact on all those early people who were probably brought along by the dream, and the loquaciousness and the passion of that particular founder.

So, realize that the founder-itis is going to happen, get ahead of it, and then have enough in your capital stack so that if they leave, they still have optionality for the future. I think you could call every founder that we have "moved on," and we've moved on over 25 of them.

You do it with respect, and you do it in a way that honors not only you, but also them. We've been pretty successful, but it's gonna happen. Think of a founder being able to take the company up to a certain level, but then at a certain point, the skills just don't exist, generally speaking, and so you have to make a move.

The other thing about personnel and CEOs and moves and founders is that you better have good olfactory nerves. In other words, you better be able to smell a rat when there is a rat. Because when you're an outsider, and you're looking into a company, you're only as good as the data that they give you. But if something doesn't smell right, go find it. Go kill the rat. Because if you don't kill that rat, it will kill the company. You have to have good olfactory senses and trust them. If something doesn't smell right, it probably isn't right.

And I'm not being trite here, I'm just saying you got to be a good people person. When somebody starts double talking, where they're telling you the same story twice, but it's not the same story, then you have a problem. You have to have a good memory too, because you get a lot of input. Founders are beautiful, wonderful. But boy, oh boy - if you don't handle it right, they could blow your company up and make your life miserable.

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Corporate Director, CME Group

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CEO & Founder, LionShare Media

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

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