



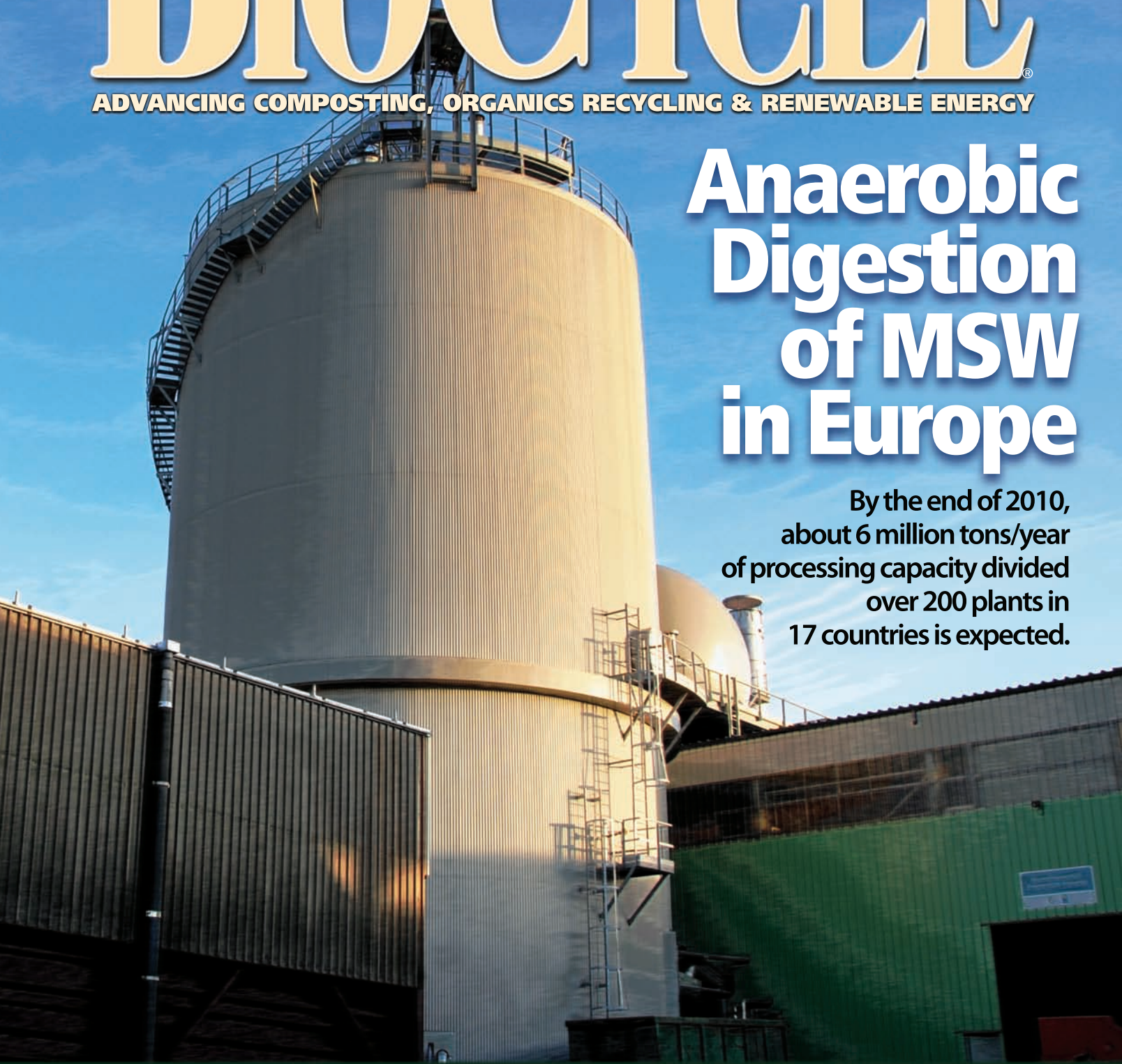
FEBRUARY 2010

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Anaerobic Digestion of MSW in Europe

By the end of 2010, about 6 million tons/year of processing capacity divided over 200 plants in 17 countries is expected.



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2010 FINANCIAL MARKETS OUTLOOK

IN OUR November 2009 article, “Debt and Equity Options For Organics Recycling Investments,” several important considerations that can influence the type of financing that might be appropriate and available were discussed. One consideration was market conditions. In this article, we will try to make sense out of what occurred in 2009, where we are today and what might lie ahead in the months and year to come. As market conditions evolve, a company’s financial tool chest contracts and expands. Depending on the type of financing being sought, gradually improving market conditions should provide greater opportunities to access the capital necessary to achieve strategic and financial objectives.

TAKING STOCK — A REVIEW OF 2009

While watching the ball drop in Times Square at a New Year’s party in December 2008, someone remarked that it would be great if two balls dropped so we could also close out 2009. Extreme pessimism abounded with many questioning whether another depression was on the horizon. Coming off the fourth quarter of 2008, when the global economy was in the medical equivalent of cardiac arrest, this high sense of anxiety was certainly understandable. Financial markets reflected this pessimism. The stock market had been declining and volatile since October 2007, but beginning in September 2008, it went into free fall. People worried about whether the cash in their bank and money market accounts was safe. No one knew how bad things could get as the market proceeded to lose virtually all the gains it had made since the mid-1990s (Figure 1).

Considering the rapid pace of economic deterioration at the time, it was far from surprising that confidence among individuals and companies plummeted. The unemployment rate doubled from five percent in January 2008 to 10 percent by December 2009 (Figure 2). On average, more than 700,000 Americans were losing their jobs every month towards the end of 2008 and the beginning of 2009, an astonishing pace of layoffs and the most since the U.S. Bureau of Labor Statistics began tracking the data in 1948. Just as significantly, many of these lost jobs are not expected to return for quite some time, if at all, particularly in industries hardest hit by the current crisis such as construction, retail and financial services.

Companies, capital providers and individuals all generally reacted to this difficult environment by hoarding cash. In fact, at the beginning of 2009, there was enough money held in cash, bank deposits and money-market funds that, if invested, could have acquired about 74 percent of the entire value of the U.S. stock market at that time — the highest ratio since 1990, according to Federal Reserve data and Bloomberg News. With this high level of cash held as “savings” rather than being spent or invested in the economy, another choke hold was placed on the prospects for recovery. Despite the apparent

Gradually improving market conditions could benefit composting and organics recycling companies’ ability to access capital.

*Andrew C. Kessler
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economic free fall, people were hopeful that the economy would somehow stabilize, even at a relatively low level, and gradually nurse itself back to health.

CURRENT AND FUTURE MARKET CONDITIONS

While the economy may still be in the intensive care unit with unexceptionally high unemployment and weak GDP growth, we have come a long way from the dark days of a year ago. Aggressive government spending and investment programs to fund economic activity (i.e., stimulus spending), combined with moderately better than anticipated corporate earnings, have all helped the economy improve at a slow pace month over month. As interest rates remain at historic lows in the U.S. and abroad, borrowers of all types may be able to secure capital at lower financing costs than was available a year ago. Lower interest rates also provide financial institutions with a much needed opportunity to strengthen their respective balance sheets as they earn significant income between the rates they pay to obtain money and the rates they earn from lending it.

While it may take significantly longer than people would like for the environment to approach precrisis levels, this incremental improvement is very important. It lends greater confidence to senior management teams, investors, lenders and other participants in the economy to take another look at investment and financing opportunities and to start putting money to work again on sensible projects with reasonable levels of risk.

As we begin 2010, we would argue a cautious optimism is building in the markets based on recent discussions we have had with dealmakers, attorneys and providers of capi-

Figure 1. S&P (Standard & Poor’s) 500, 1995 – 2009

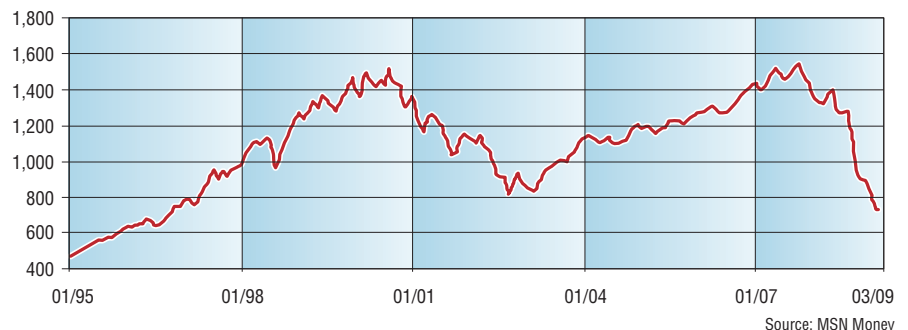
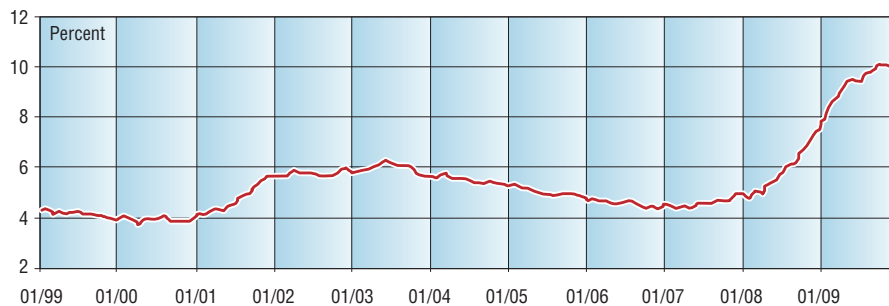


Figure 2. U.S. Unemployment Rate, 1999 – 2009



Source: U.S. Bureau of Labor Statistics

tal from a variety of markets. Although there are still significant risks around this confidence to be sure (e.g., inflation, the potential for greater government scrutiny/regulation, sovereign and corporate credit risk, and continued weakness in the U.S. dollar), many of the current trends in the market are encouraging, which should benefit the broader economy as well as our industry. Several of these trends and their impact on a company's financial tool chest are outlined:

Availability Of Credit: While media headlines continue to highlight the general lack of credit available in the marketplace, large companies have not only regained access to the credit markets, but the environment for new bond issues has actually been quite robust. Investors are seeking greater yields and are increasing their purchases of corporate debt, resulting in lower costs for borrowers.

Although large companies have regained access to credit, the situation remains challenging within the composting and organics recycling sector, which is much more heavily weighted towards small and mid-size businesses. This lag is not unusual. In times like these, it is often easier to pursue a larger fundraising than a smaller one as the potential investor pool is arguably larger and the perceived risk associated with providing credit to a larger company is thought to be lower than the risk associated with lending to a smaller, regional company. That said, improvements in the credit markets should gradually migrate to smaller firms. A gradual return to normalcy in the credit markets becomes the rising tide that eventually lifts all boats. If you are a small or mid-size company seeking growth capital, you may want to begin preparing for a capital raise so you are ready and can immediately take advantage of improving conditions.

Rise In Spending: Some analysts estimate that if you add it all up, corporations have at least \$250 billion more cash on hand than they did in 2007 before the financial crisis began. Companies will typically look at three avenues to deploy this cash in the months ahead: greater capital expenditures, acquisitions of other companies or assets, and/or greater payouts to shareholders through stock buybacks and dividend increases. Importantly, all three paths inject cash into the system, fueling further potential growth.

Increases in corporate and individual spending will have a direct and positive im-

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impact on our sector. As our customers gradually increase spending to more normalized levels, product demand should increase. Overall improvements in economic activity add further liquidity to the financial markets, which should help accelerate the availability of capital to small and mid-size companies.

Tepid But Increasing Consumer Confidence: While the American public is still reeling from high unemployment and lackluster economic growth, it is gradually gaining back some degree of hope and confidence in the future. The University of Michigan Consumer Sentiment Index is a monthly gauge which measures a range of consumer attitudes on the business climate, personal finance and spending. People also view it as a general barometer on the level of optimism or pessimism exhibited overall by consumers. The index hit monthly lows in late 2008/early 2009 in the mid-50s and has had a moderate rebound to 72.5 as of December 2009. While still relatively low, this was still its highest monthly reading since January 2008.

Rise In Mergers and Acquisitions (M&A): Although M&A transaction volume plummeted in late 2008 and the first half of 2009, global M&A volume surged by 90 percent quarter-on-quarter to \$627 billion in the last three months of 2009, according to Mergermarket. Deals are also now being pursued for growth or cost cutting reasons rather than out of pure necessity to avoid bankruptcy. Recent large deals include Kraft/Cadbury and Berkshire Hathaway/ Burlington Northern Santa Fe.

At the other end of the size spectrum, small and mid-size transactions also are beginning to increase as acquisition financing is becoming obtainable. We expect to see more interest from private equity and strategic investors in smaller transactions as opposed to the large blockbuster type deals of recent years. Already this year within our sector, we have seen Waste Management, Inc. make a strategic investment in Harvest Power, Inc. That investment follows the October 2009 acquisition by Harvest of Fraser Richmond Soil and Fibre, a commercial composting operation based in Vancouver.

Narrowing The Valuation Gap: Similar to what we have seen in the residential real estate market, different views on valuation of companies had represented a significant hurdle to getting a buyer and seller to agree on price. Despite the economic meltdown, sellers still thought their companies were worth what they thought they were worth in the good times. On the other hand, buyers' views on valuation reflected the economic climate and increased cost of capital. This valuation gap, combined with other challenges in the market, served as a hindrance to the process of matching capital with opportunities. However, the gap has been steadily narrowing as sellers recognize the world has changed and buyers are finding more capital at better pricing to help fund the deal. Although valuations are certainly lower across the board than they were two years ago, deals are getting done again and increasingly so.

Equity Markets Have Reopened: The public equity markets have opened up, allowing companies to raise equity capital to fund growth, acquisitions and investments. There were 67 initial public offerings (IPOs) registered for companies in the September through December 2009 period as compared to only 8 for the first eight months of 2009, according to the *Wall Street Journal*. As of the time of this writing in early February, there have been seven IPOs for year-to-date 2010 with another 10 registered to occur.

Similar to what we are seeing with favorable credit markets experienced by larger companies gradually migrating to the smaller ones, the momentum in the public equity markets for raising capital should gradually trickle down and positively impact the ability of small and mid-size companies to raise equity capital. We have already seen examples of this within the organics recycling sector from both the public and private equity markets. In late October 2009, Converted Organics Inc. raised \$18.3 million from the public equity market. In late December 2009, Harvest Power, Inc. held a \$10 million closing of its Series A1 private equity financing which brought its equity financing in 2009 to \$18 million.

Stock Market History As Precedent: Famed investor Warren Buffett is quick to note that the biggest gain the Dow Jones Industrial Average had ever notched in the postwar period came in 1954 after the early 1950s recession. Although unemployment was also relatively high then, the Dow jumped by almost 40 percent that year. It is important to remember that unemployment is always viewed as a lagging economic indicator, hence the market's resurgence in 1954 even when far too many people were still out of work. Another famous market participant, James Grant of Grant's Interest Rate Observer, believes the market will be stronger than people expect, recently telling *Forbes* that "growth snapped back following the depressions of 1893-1894, 1907-1908, 1920-1921 and 1929-1933. If ugly downturns made for torpid recoveries, as today's economists suggest, the economic history of this country would have to be rewritten."

Attractiveness Of All Things "Green": In a very difficult market, approximately \$155 billion was invested in clean energy companies and projects worldwide in 2008 (excluding large hydro projects), a four-fold increase since 2004, according to Global Trends in Sustainable Energy Investment 2009, prepared for the United Nations Environment Programme's (UNEP) Sustainable Energy Finance Initiative by global information provider New Energy Finance. Of this amount, \$13.5 billion of new private investment went into companies developing new technologies alongside \$117 billion of investment in renewable energy projects.

In addition, the increased attention to products like compost, which can make an immediate, positive impact on mitigating climate change is attracting new interest. The myriad environmental benefits of compost and its important role in waste management,

water conservation, sustainable agriculture, carbon sequestration and soil fertility is becoming increasingly recognized by more and more players, including investors, politicians, the general public and users of compost. But in order to convert this interest into investment capital, we must demonstrate to investors how these trends and benefits will lead to increased growth rates and cash flow for our industry. Investors as individuals may care deeply about the environmental benefits of organics recycling and compost but as investors, it's cash flow that matters.

THINK OUTSIDE THE BOX

While the past two years have been a historic period for our country in terms of economic uncertainty and value deterioration, the U.S. and global economies are gradually recovering from their respective low points and markets have generally reacted strongly in anticipation of better days ahead. We believe the business and financing environments will continue to heal with a good probability that, as these favorable trends progress, we could see a sharp acceleration in economic activity based on the amount of pent-up demand for capital and transactional activity. Although we continue to live in an environment full of major risks, including the potential for significant inflation, the worst of the storm appears behind us. It will take some time to repair the economic and psychological damage this storm left behind; however, we are seeing signs that indicate capital is returning to fuel new and established companies.

Our advice to smaller and mid-size companies is to think outside the box. Look ahead and anticipate how evolving market conditions might impact your financial tool chest. As conditions continue to improve and the positive economic impact of these changes increasingly trickles down to all segments of our economy, be prepared to avail yourself of all financing alternatives — not just the ones upon which you have traditionally relied.

Though the past two years have presented many financial challenges for organics recycling companies, the potential to capitalize on emerging trends and opportunities is on the horizon. Now is the time to position your company to make the most of the opportunity. Have all financial tools primed and at the ready so that as market conditions improve, you are poised to act. ■

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