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Building a Portfolio With a Focus on a Single Sector: Water

BY ERICA GIES



Chris Young for The New York Times

John Coburn, left, and David Henderson, co-founders of XPV Capital, a venture capital firm that invests in companies connected to water.

In the late 1990s, David Henderson and Khalil Maalouf bet big on young telecommunications companies, as industry landscape was changing drastically. Then the bubble burst, and the two investors got burned.

Even so, they didn't lose faith in the concentrated philosophy. In their view, the single-sector portfolio made sense. They could develop true expertise in the area, cultivate a deep bench of potential talent and encourage partnerships among their companies.

A few years later, they found a new focus, close to home on the shores of Lake Ontario in Toronto: water. With concerns over the supply and pollution intensifying, they saw a wide range of investment opportunities. They also saw the potential for profit after General Electric bought

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a Canadian water-treatment company, Zenon Environmental, for \$655 million in 2006.

Now, their venture capital firm, XPV Capital, is part of the growing group of investors, entrepreneurs, scientists and government groups focused on problems affecting the water supply — pollution, population growth, urbanization, climate change, aging infrastructure — and the potential solutions. As the investors see it, technology is shaking up the business, in the same way that developments like cellphones altered the telecom landscape.

XPV, which has \$150 million under management, owns stakes in just eight companies, all connected to water. One investment, Newterra, builds modular systems to clean wastewater in remote locations, such as mining operations or off-the-grid housing developments. Another holding, FilterBoxx Water and Environmental, cleans wastewater from Alberta's tar sands.

“There are now seven billion of us on the planet. There are more contaminants, more challenges around water access, more years of avoiding spending on infrastructure, which has taken it to the verge of collapse,” said John Coburn, a former executive at Zenon Environmental who teamed up with Mr. Henderson and Mr. Maalouf to form XPV. “So they're going to need all kinds of technology.”

When the three investors set up shop, Toronto was the natural choice. For decades, the area has been a center of innovation in the water sector.

Places like Israel and Singapore are driven by scarcity to develop water technology, but Ontario's culture of innovation is a product of its water wealth. The Great Lakes region has long attracted water-intensive industries such as mining, food and pharmaceuticals. But industrialization led to water pollution, prompting regulation and, eventually, investment in technology.

Today, the province employs 22,000 people in the sector, according to the Ontario Ministry of Economic Development, Trade and Employment. It boasts 900 water industry firms, 21 water-related research institutions and 20 universities that offer programs in water science.

Tax incentives for business and research have helped spur more growth. One of the firm's holdings, Newterra, has benefited from provincial government support, including access to consultants and information, and collaboration with Ontario's publicly funded universities.

Such connections led to XPV's first investment. In 2009, a multinational industrial company reached out to the firm for insight on how to improve water management for their clients. During the meeting, the company said it used a technology from APTwater, a company based in Long Beach, Calif. After doing its own research, XPV decided to take a stake in APTwater, which also counts the venture capital firm Kleiner Perkins Caufield & Byers and the venture arm of Waste Management among its investors.

“They had used one of APT's technologies and incorporated it into their process,” Mr. Henderson said. “That told us that the technology was fully commercialized and valid.”

Since investing, XPV has helped APTwater move from the commercialization phase to a global company that cleans various forms of tough wastewater, such as leachate from landfills, nuclear wastewater and coal bed methane wastewater. On the advice of XPV, APTwater has hired senior executives from its network of Ontario entrepreneurs and has made acquisitions to fuel growth and expand its technology portfolio. In 2011, APTwater bought Rochem, a German company that builds reverse osmosis modules to clean water.

“We've become an accepted member of the water community,” Mr. Henderson said. “We're no longer considered V.C. or finance guys. We see more unique things because we're insiders.”

As part of its investment process, XPV focuses heavily on management. In 2011, the investment firm helped recruit Larry Novachis, a Zenon and General Electric alumni, to run FilterBoxx. Last year, FilterBoxx set up an office in Ontario to tap the area's talent pool.



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"I was able to draw upon people I know from the Zenon days and G.E.," Mr. Novachis said.

XPV also helps make connections in its own portfolio. APT recently licensed one of its technologies to FilterBoxx for applications in the tar sands.

"The value of being a sector-focused fund is having a portfolio of companies that complement each other," Mr. Henderson said.

As a focused firm, XPV has to be more careful about its picks than venture capital firms with large, diversified portfolios. Home runs — investments that offer the potential for 100 percent returns or more — are also less likely.

"The average expected returns out of these companies will be three to seven times the investment," Mr. Coburn said. "If you can't have big winners, then you'd better avoid losers."

To do so, XPV looks for companies that are on the verge of gaining commercial traction.

In 2010, the investors started looking at BCR Environmental, a company based in Jacksonville, Fla., that is developing a method to treat the waste left over after sewage processing. But XPV waited until the [Environmental Protection Agency](#) approved the company's technology and invested the next year, later assisting BCR in scaling up its operations.

Mr. Coburn said BCR's value doubled in each of the last two years and he expected that pace to continue for a few more years, because BCR has few competitors and the E.P.A. approval process is extensive. By the time another company makes it through, "we'll have exited the company," he said.

"We don't make bullets, cigarettes, bombs," Mr. Coburn said. "Our companies are doing great things for wastewater treatment. If you get the right company, it's a high."

A version of this article appears in print on 11/01/2013, on page B5 of the New York edition with the headline: Building a Portfolio With a Focus on One Sector: Water.

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