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Up Front



Go ahead. Drink this cocktail with real gold flecks. It's for the Olympics. **PAGE 3**

News & Analysis



A new tax for a downtown streetcar? Not all businesses are on board. **PAGE 6**

People



Why every L.A. ad exec knows Susan Franceschini. **PAGE 19**

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Mussel Man: KZO CEO Phil Cruver with shellfish from the San Pedro Shelf.

DIVING IN

Sea farmer hopes to harvest shellfish off Long Beach

By **JOEL RUSSELL** Staff Reporter

IF you sail out a few miles off the Long Beach shore, one day next year you might see a series of buoys bobbing on the swells. But you won't see what's below: a multimillion-dollar oyster and mussel farm.

If **Phil Cruver's** plans work out, there will be thousands of cages of oysters under the buoys and tons of mussels clinging to ropes that dangle from the buoys to the ocean floor.

His company, **KZO Sea Farms** in Long Beach, last month received preliminary approval to develop a 100-acre farm for oysters and mussels about eight miles off the shore of Long Beach. The operation still needs financing and his plan needs additional regulatory approval, but if it works out, it apparently would be the first big open-ocean oyster farm off Southern California.

KZO's strategy is to reproduce on a large

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SPECIAL REPORT INNOVATION / TECH TRANSFER

Lab to Market

Carlos Camara, an inventor at **TRIBOGENICS** of Marina del Rey, is developing portable X-ray technology. His company is one of many spun off from L.A.'s top research universities. You can see more examples of local innovations that may soon be products in this Special Report.

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LAUSD Fails Public Station

TV: KLCS forced to scramble after district cuts subsidy.

By **JONATHAN POLAKOFF** Staff Reporter

When **Bob Bergen**, the actor who voices Porky the Pig, stutteringly says "That's all, folks," he's closing out an episode of Looney Tunes. But he took the shtick to the air this summer to do something altogether different.

He asked viewers to donate money to **KLCS-TV (58)**, a small PBS affiliate in downtown Los Angeles that is the poorer cousin to the area's larger public TV stations.

Pledge drives are staples of public television, but they are new to KLCS, a station that bills itself as "The Education Station" and has carved out a

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Gas, Oil Power Turbine Maker

ENERGY: Capstone charges into industry to boost sales.

By **JAMES RUFUS KOREN** Staff Reporter

On a marshy oil patch next to a gated Costa Mesa community, Chatsworth manufacturer **Capstone Turbine Corp.** has finally found a home.

There, at the West Newport oil field, tiny **West Newport Oil Co.** is using a Capstone turbine generator. Fueled by natural gas that comes up along with crude oil, the generator produces

58%
Amount of Capstone's revenue from oil companies, up from 39 percent the year before.

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Businesses Draw The Line on Taxes From Other States

By **HOWARD FINE** Staff Reporter

A tax nightmare began for **Pete Vegas** when a truck carrying his L.A. company's food made a routine stop at a weigh station in Washington state.

It's cost him hundreds of thousands of dollars. And he's now taking part in an intensifying battle over states' rights to tax companies where they don't have facilities or employees.

Business groups contend states should not have the authority to impose such taxes. State tax collectors say they have a right to collect billions

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Energy: Turbine Company Spins Oil, Gas Deals

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electricity that helps power oil pumps and other equipment.

That natural gas, which comes in quantities so small it's not worth selling to a utility, normally would be "flared off" or burned at the site. Instead, West Newport uses the byproduct to produce about one-third of the well's electricity needs.

"The (small) amount of gas we produce, it's just a problem," said **Tom McCloskey**, operations manager for the oil company. "So we like to use what little gas we do produce to produce electricity in-house. It's a great advantage to produce your own electricity."

It's the same story at oil and gas fields near and far, from Signal Hill in Los Angeles County to the deserts of southwest Texas to Russia's vast Siberian wilderness.

For the past two years, oil and gas companies – and especially American firms cashing in on the glut of domestic oil and gas reserves opened up by the controversial practice of hydraulic fracturing – have been buying Capstone's turbines: essentially small-scale jet engines that generate electricity instead of thrust.

Those sales have boosted the long-struggling company's revenue above \$100 million and pushed it closer to profitability. Customers include Oklahoma City's **Chesapeake Energy Corp.** and Houston's **Marathon Oil Co.**

"We're seeing increased demand for our product," Capstone Chief Executive **Darren Jamison** told investors on a June conference call. "We started with (Anadarko Petroleum Corp.), which got us Chesapeake, which got us Marathon Oil, **Talisman**, then **Shell**. We continue to get repeat orders from almost all these customers."

The oil and gas industry isn't a new market for Capstone, but it has quickly become the company's largest one – and it's still growing. In 2011, the oil and gas sector represented about \$32 million in sales, or 39 percent of Capstone's revenue. In the fiscal year ended March 31, sales to oil and gas companies nearly doubled and comprised 58 percent of revenue.

That revenue growth helped the company post its first positive gross margin last year. But net profits are still a long way off – the company lost \$18.8 million last year – and the explosion in revenue from the oil and gas industry highlights the uncomfortable fact that Capstone hasn't been able to attract as many customers in other target sectors.

Executives would like other sales to take off so that oil and gas companies would represent a smaller part of Capstone's future sales. But with the company's turbines costing about 30 percent more than traditional piston-driven generators with similar output, it's not proving easy to get those other deals.

West Newport won't disclose what it spent on its Capstone generator but it uses a midsize 65 kilowatt model that by one estimate costs nearly \$200,000 installed. Assuming a 30 percent premium, competing piston-powered generators would cost about \$150,000.

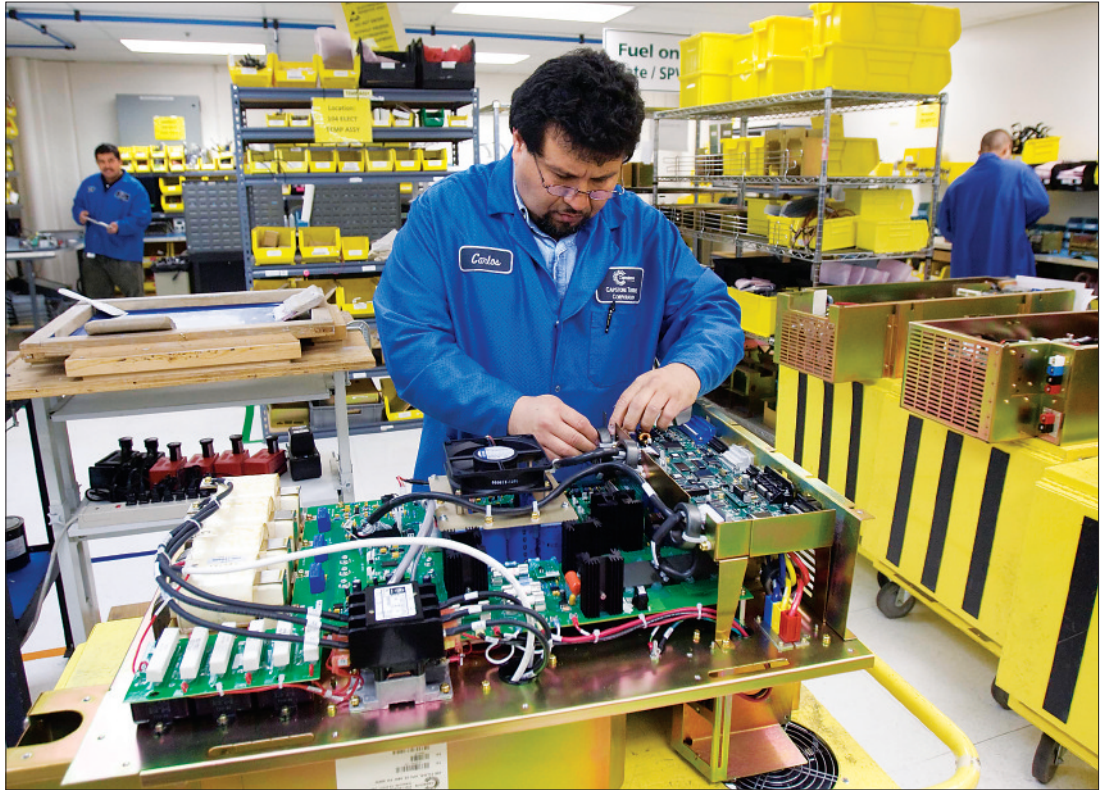
To expand its presence in other markets, including transportation and telecommunications, Capstone will need to bring that price down, said **Shawn Severson**, who follows Capstone stock as managing director of clean technology research at **JMP Securities** in San Francisco.

"They have to be more cost-competitive with traditional technologies," he said. "If you were price competitive in upfront costs, then it would be much easier to consider the microturbine."

Niche markets

Capstone microturbines – micro because they are much smaller than the turbines used in steam-generating power plants and even those in most jet engines – burn pressurized gas or liquid fuel to spin the drive shaft of an electric generator.

Capstone's products range from about the size of a refrigerator, producing 30 kilowatts of



PHOTOS BY RINGO H.W. CHIU/LABJ

Getting Connected: Worker assembles turbine at Capstone's facility in Chatsworth.



Powered Up: Chief Executive Darren Jamison with a Capstone microturbine.

power, to about the size of a 40-foot shipping container, producing 1 megawatt. Capstone's 1 megawatt unit costs about \$1.4 million; the company said a unit of similar size from a competitor would cost about \$1.1 million.

But Capstone turbines' use of flare gas and their relatively compact size make them a good fit for oil and gas companies, which need electricity to run pumps and other equipment at remote production sites. The turbines also use less fuel than other generators – the company said its turbines burn more efficiently than pistons – helping oil and gas companies meet strict regulations on emissions from drilling sites.

McCloskey of West Newport said the Capstone turbine at its Costa Mesa well supplies about one-third of the pump's electrical demands, with the rest coming from nearby power lines operated by a utility.

Capstone is not the only company that makes generators that can run on natural and flare gas. Its competitors include **General Electric Co.** of Fairfield, Conn., and other companies that make less expensive piston-driven generators. But McCloskey said he

went with a Capstone model because it uses much less fuel and has such low emissions that he did not need a permit to install it.

"This one's got the state certification, so it's good to go," said McCloskey, who noted West Newport would have needed a permit – which is not simple or cheap to obtain – from the South Coast Air Quality Management District for a standard generator.

West Newport is a small local operator, but Capstone over the past 18 months has sold turbines to oil and gas producers across the country. In April, the company announced the sale of 30 turbines to oil and gas companies with operations in Texas' Eagle Ford Shale play.

The company has also announced big sales abroad, where foreign governments are starting to push oil and gas producers to use flare gas as a fuel instead of burning it to get rid of it. Moscow-based **Lukoil OAO** recently purchased 17 Capstone turbines for an undisclosed sum for its Siberian fields.

"Flare gas is this huge problem in Russia, in Africa," said **Jim Crouse**, Capstone's vice president of sales and marketing. "Countries

are limiting the amount of gas you can flare without utilizing it for some beneficial purpose. That's a market that's growing and will continue to grow."

Slower sales

But other markets that Capstone hopes to tap haven't taken off.

In investor presentations, company executives have said they believe the transportation market – turbines for hybrid buses and ships – could eventually be about 12 percent of its business. They estimate generators for data centers and telecommunications equipment, which require an uninterrupted power supply, could be another 14 percent of sales.

But today, those markets each represent less than 1 percent of Capstone's revenue.

Crouse said it's no surprise that oil and gas customers have been earlier adopters. Big firms such as Chesapeake are willing to pay a premium for the generators because emission regulations and because their fuel efficiency can lead to long-term savings.

"Oil and gas customers tend to be more sophisticated buyers," Crouse said. "They'll understand you may have to pay a premium of 20 percent on day one, but that will come back to them. Other customers aren't making decisions based on the lifecycle costs. They're more focused on what it costs on day one."

The company sells turbines through independent distributors and does not report turbine prices, but **Steven Acevedo**, president of San Juan Capistrano distributor **Regatta Solutions**, said a Capstone system costs between \$3,000 and \$4,000 per kilowatt, including installation. That's about 30 percent greater than others.

Severson, the JMP analyst, agreed that higher upfront cost is a barrier for potential customers. He said it will be important for Capstone to lower prices to become more competitive in other generator markets. But he added that even without lower prices, it should be easier for Capstone to begin selling more turbines because it's sold so many to oil and gas customers.

"People have seen them working, they know they work," he said. "You can show off existing customers to potential buyers."