TECHNOLOGY EDITION

The Venture Capital Analyst

TRACKING INNOVATION AND THE MONEY BEHIND IT » SEPTEMBER 2003 | VOLUME VI | ISSUE 9

In This Issue

Also Inside

Some Early-Stage Investors Adding Buyout Deals to Their Repertoires

Low Prices Help Drive Trend; Do VCs Have the Right Skills?

Austin Ventures, one of the stalwart early-stage technology investors of the late 1990s, in July took on the role of a buyout investor, agreeing to pay more than $100 million to acquire **Staktek Corp.,** a privately held maker of computer-memory modules.

Atlas Venture and **Benchmark Capital,** meanwhile, intend to acquire London-based data warehousing and management software startup **Kalido Inc.** for $18 million. And **Battery Ventures** spent $30 million to buy **Made2Manage Systems Inc.,** a publicly traded enterprise software vendor that targets small and midsize manufacturers. Other venture firms that have become active in the buyout field include **Oak Investment Partners,** Westport, Conn., and **August Capital Management,** Menlo Park.

This burst of activity reflects a number of factors, including the low valuations of companies that went public during the tech boom, the lack of IPO opportunities for today's generation of startups, and the sense that some technology markets have matured to the point at which VCs face long odds in building companies from scratch. Venture firms may also have been inspired by the rich returns realized by the investors, including August Capital, which acquired Seagate Technologies in 2000. Less than a year after the hard-drive

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Venrock's Tech Team Shrinks Further As Firm Sets Course on Smaller Fund

Venrock Associates, one of the nation's oldest venture firms, is entering the fund-raising market with a much smaller technology team than the one in place early this year.

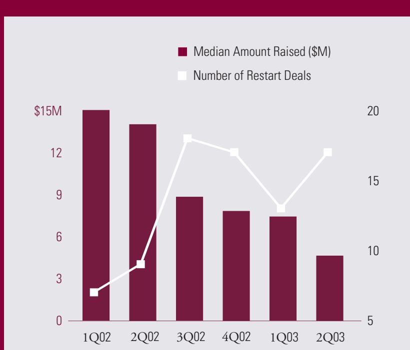
Two more tech investors—Managing General Partner David Hathaway and General Partner Joseph Casey—will not be involved with the new fund, which, according to a source close to the firm, has a target range of $450 million to $500 million. Venrock's current fund, which it raised in 2000, totals $657 million.

Tom Frederick, another general partner, left the firm in the spring. In July, General Partner Terry Garnett began raising money for a technology buyout fund that he will head with former ComVentures General Partner David

>continued on p.15

The Workout Continues

VCs are still re-capitalizing, or restarting, a significant number of IT companies, but they are investing less in these deals.



Source: VentureOne

NEWS

Charles River Ventures Likely to Seek No More Than $300M for Twelfth Fund

Charles River Ventures, Waltham, Mass., which made news a year ago by slashing its $1.2 billion fund to $450 million, expects to return to the market later this year with a new fund that will be smaller still.

Although the firm has made no decision, according to General Partner Christopher Baldwin, "Odds are high that it's going to be less than the current fund," probably in the $200 million to $300 million range. He said a smaller fund makes sense at a time when start-ups are capital-efficient and concentrating on innovative technology rather than trying to meet a rapidly escalating demand for more network capacity.

Mr. Baldwin, who joined Charles River in 1999, also said the firm is not yet prepared to discuss the makeup of the partnership for the new fund, which will be the firm's twelfth. Rick Burnes, who co-founded Charles River in 1970, has been scaling back, and General Partner Ted Dintersmith is moving to South Carolina, although there is no indication that he is leaving the firm (*Venture Capital Analyst-Technology,* June, page 7). General Partner Bill Tai, formerly of **Institutional Venture Partners,** joined Charles River last year, and the firm is looking for another partner to join him in its Menlo Park office. Charles River has 10 partners.

Limited partners in **Charles River Partnership XI, L.P.,** include **Cornell University, FLAG Venture Management, Massachusetts Pension Reserves Investment Trust, Pennsylvania State Employees Retirement System** and **Virginia Retirement System.**

In a recent interview, Mr. Baldwin talked about some of the technologies that interest the firm. One is broadband service to homes. Charles River is betting on cable technology because carriers have strong relationships with content providers. It backed RiverDelta Networks, a Tewksbury, Mass., network-equipment maker that Motorola acquired in 2001 for $309 million in stock. The firm also has invested in **BigBand Networks Inc.,** Redwood City, Calif., which sells multi-media routers; **Broadbus Technologies Inc.,** Boxborough, Mass., which makes video servers; and **Cedar Point Communications,** Derry, N.H., which sells voice-switching technology.

In the storage and data-center sector, two of its companies just closed second rounds. Mr. Baldwin is on the board of one of them, **Revivio Inc.,** Lexington, Mass. **Globespan Capital Partners,** Boston, led the $20.7 million round for the software company. First-round investors **Bessemer Venture Partners,** Wellesley, Mass., and **Flagship Ventures,** Cambridge, Mass., also participated in the financing, which Mr. Baldwin said closed in only six weeks.

The other is **Acopia Networks Inc.,** a Chelmsford, Mass., developer of network-management equipment. Other investors in the $30 million round included **Accel Partners,** Palo Alto, and **St. Paul Venture Capital,** Eden Prairie, Minn. Charles River also co-led a $6 million first round along with Flagship Ventures for **Trusted Network Technologies Inc.** The company, based in Alpharetta, Ga., near Atlanta, sells access-control technology. This was Mr. Dintersmith's second deal this year.

Other areas that Charles River is pursuing, Mr. Baldwin said, are enterprise software and technology to protect and distribute intellectual property. Charles River also is interested in wireless technology but has steered away from local-area networks in favor of wide-area networks and short-range technology for linking electronic devices.

Although the firm has chalked up no exits from its current fund, it has had three from the $505 million predecessor fund it closed in 1999. Besides RiverDelta, they are Hammerhead Networks, which Cisco Systems bought for $173 million in stock; and Pirus Networks, acquired by Sun Microsystems for $160 million in stock.

Reach Charles River at (781) 768-6000.

Sequoia Drops Michigan; U. of Calif. Appeals to Judge

Don't expect a reconciliation between **Sequoia Capital** and the **University of Michigan** any time soon.

The Menlo Park firm revealed in late July that it had shut Michigan out of its latest fund and forced it to withdraw from six others after the university, in compliance with open-records laws, disclosed the financial performance of Sequoia and numerous other venture firms.

Meanwhile, **University of California,** another Sequoia limited partner, has asked Alameda County Superior Court Judge James Richman to reconsider his ruling that California must release performance data on the funds it has backed. California argued that disclosing the information would jeopardize its ability to invest.

Sequoia spokesman Mark Dempster wouldn't comment on Michigan's ouster. Julie Peterson, a spokeswoman for the endowment, said, "We certainly value our relationship with Sequoia and would rather not see it end. We haven't decided on our next course of action, but there is nothing changing in our legal environment that I'm aware of.

NEWS

"[Disclosure] is an ongoing issue for us," Ms. Peterson said. "We've been in discussions with a number of investment partners who are concerned by the public disclosure laws by which we have to abide."

As of June 2002, Michigan had 4.3 percent of its $3.4 billion endowment invested in venture capital funds, with $54 million of that in funds managed by Sequoia. Other venture firms backed by Michigan include **Kleiner, Perkins, Caufield & Byers, Menlo Ventures** and **Morgenthaler Ventures** of Menlo Park; **Matrix Partners**, Waltham, Mass.; **Accel Partners**, Palo Alto; **Battery Ventures**, Wellesley, Mass.; and **Oak Investment Partners**, Westport, Conn.

Private universities with monies in Sequoia funds include **Cornell University, Duke University, University of Notre Dame** and **University of Chicago.** While the financial data of private universities is not subject to open-records laws, **Yale University** has come under pressure from its unions to be more open about its venture capital investments.

Rustic Canyon, Staenberg Join to Raise SBIC Fund

In another example of consolidation within the venture industry, the former venture arm of Times Mirror Co. has teamed up with an established Seattle investor to form a Small Business Investment Company fund.

Rustic Canyon Ventures, Santa Monica, Calif., is preparing to close on $175 million, with $130 million of that coming through the SBIC program. Jon Staenberg, the managing partner of Seattle-based **Staenberg Venture Funds**, is helping to raise the private capital and is joining Rustic Canyon as a partner.

Mr. Staenberg, who has made only two investments over the past 16 months, said the alliance with Rustic Canyon gives him access to money he would have had a hard time raising on his own. Rustic Canyon, in exchange, will now have a presence in the Northwest. The Rustic Canyon fund is intended for investments in areas including network security, wireless local area networks and storage management.

Rustic Canyon has close ties to the Chandler family, which owned the *Los Angeles Times* and other newspapers prior to their sale to Tribune Co. in 2000. Led by Tom Unterman, Times Mirror's former chief financial officer, Rustic Canyon that year began investing $550 million of Times Mirror and Chandler Trusts money.

According to VentureOne, Rustic Canyon has backed a total of 51 technology companies, with 14 of those eventually going out of business and nine being sold. None has gone public. Twenty-eight remain privately held.

The same year that Mr. Unterman set out on his own, Mr. Staenberg raised $60 million for **Staenberg Venture Partners II, L.P.** Mr. Staenberg's firm, according to VentureOne, has backed a total of 109 companies, 42 of which remain privately held. Thirty-four have gone out of business, 27 have been sold, and four went public.

According to VentureOne, Staenberg Venture Partners' most recent first-time investment came in June of last year, when it supplied $4 million to wine-shipment company **New Vine Logistics,** Oakland, Calif.

Rustic Canyon, meanwhile, last made an investment from its original $550 million pool in October 2001. But it has made two investments through the new fund. In July, it led a $12 million third round for **StoneFly Networks,** a San Diego developer of Internet Protocol storage devices. In March it led a $14 million second round for **NanoNexus,** the Fremont, Calif., maker of scalable electric connectors.

"We kept looking at new companies last year," said Mr. Unterman, "but the landscape was so precarious that deals just didn't come together."

Reach Mr. Unterman in Santa Monica at (310) 998-8000. Reach Mr. Staenberg in Seattle at (206) 770-5775.

Viventures to Continue Under New Ownership

Viventures Partners, the venture firm launched by French media conglomerate **Vivendi Universal** in 1998, plans to continue making new investments, despite a change in ownership and a new name.

Hamilton Lane Advisors Inc., Bala Cynwyd, Pa., and technology investment firm **Global Asset Capital,** Menlo Park, has acquired Viventures' portfolio as well as its 10-member investment team, and renamed the group **VSPA.**

Managing Director Edward Colby will continue to head the group's San Francisco office, while Managing General Partner Jean-Pascal Tranié will remain in charge in Paris. VSPA also will be active in London, according to Hamilton Lane CEO Mario Giannini.

Unlike most corporate venture affiliates, Viventures drew more than half of the capital it raised from outside investors, including **British Telecom, China Industrial Development Bank, Cisco Systems, General Electric, IBM Corp., Procter & Gamble, Qualcomm** and **Siemens AG.** Its initial fund closed in 2000 at €120 million. The following year, Viventures drew €600 million for a successor fund, but last year reduced that amount to €480 million.

According to VentureOne, Viventures has backed a total of 60 companies, 33 of which remain privately held. Four companies went public, eight have been acquired, and 15 are either out of business or in bankruptcy protection.

Hamilton Lane and Global Asset

NEWS

Management acquired venture stakes totaling more than €120 million. So far this year, according to VentureOne, Viventures had made just one new investment, supplying $1.3 million in the first round for **OKYZ,** a Paris developer of graphics and publishing software.

Reach VSPA's San Francisco office at (415) 615-6900.

St. Paul's Gorman Becomes Managing General Partner

St. Paul Venture Capital, which last year named a pair of managing partners to replace the retiring Patrick Hopf, has made another management change as it looks toward a fund in 2005 or 2006 that would include other limited partners besides **St. Paul Cos.**

Software investor Michael Gorman has joined communications specialist Zenas Hutcheson as managing general partner, replacing David Stassen. The firm decided that Mr. Stassen, who remains a general partner, should concentrate on his health care investments, Messrs. Gorman and Hutcheson said in an interview. Mr. Stassen, who rejoined the firm in 2000 after leaving in 1991 to head Spine-tech, is on the boards of four private companies, according to VentureOne.

The firm announced the appointment of Messrs. Hutcheson and Stassen in February 2002 to succeed Mr. Hopf, who founded St. Paul Venture Capital in 1988 as the venture arm of the insurance company. It spun out as an independent firm in 1997. The St. Paul Cos. has remained its only limited partner.

In October 2000, St. Paul Cos. capitalized the firm's sixth fund with $1.3 billion. Based in the Minneapolis suburb of Eden Prairie, and with offices in Westborough, Mass., near Boston and in Menlo Park, St. Paul Venture Capital is one of the nation's most active venture investors in health care and technology.

Lately, however, the insurance company has been looking to reduce its allocation to private equity, which accounted for 3 percent of its investments in 2002. Its private equity portfolio posted a $200 million loss last year after losing $43 million the year before and gaining $554 million in 2000. The insurer is looking for less exposure to equities in general, which it sees as too volatile.

According to its latest annual report, the insurance company expects to finance its remaining venture capital obligations largely from venture capital distributions. As of the end of the year, its remaining commitment to the current fund, **St. Paul Venture Capital VI LLC,** totaled $620 million. The St. Paul Cos. can stop financing the fund at any time, but must contribute $250 million to a termination fund and pay additional termination and management fees.

Nonetheless, Messrs. Gorman and Hutcheson said they expect St. Paul to meet its commitments to the fund and to make a significant investment in the next fund. Neither the size of that commitment nor of the next fund has been determined, they said. "We expect it will be smaller than $1.3 billion," Mr. Hutcheson said of the fund size, "but the parameters have not been established."

As a result of its limited partner's goal to reduce its private equity exposure and of the venture firm's desire for a more stable investor base, St. Paul Venture Capital will be looking for other LPs for the first time when it seeks a new fund in late 2005 or early 2006. "We expect to be very selective about adding a few quality limited partners whom we can work with on a long-term partnership basis," said Mr. Hutcheson. "We believe that having a broad base will ensure that we'll be in business for a long time."

St. Paul Venture Capital expects to invest $165 million this year, up from $101 million last year. About half of the $165 million is slated for first-time investments.

Reach St. Paul Venture Capital at (952) 995-7474.

SEND PRESS RELEASES TO *VENTURE CAPITAL ANALYST–TECHNOLOGY,* 170 LINDEN ST., WELLESLEY, MA 02482-7919. OR FAX TO (781) 304-1440.

The Venture Capital Analyst | Technology

The Venture Capital Analyst | Technology is published 12 times a year by the Alternative Investor division of Wicks Business Information LLC. ISSN 1099-9302. Alternative Investor is located at 170 Linden Street, Wellesley, MA 02482-7919. Tel: (781) 304-1400. Fax: (781) 304-1440. Subscriptions $1,195 a year in the U.S. Add $75 for addresses outside the United States. Single issue price $120.

Alternative Investor | The Private Equity Analyst | VentureOne

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STAFFING NEWS

Mobius Founder Russell Now With Diamondhead

E. **Scott Russell,** one of the founders of **Mobius Venture Capital,** Palo Alto, joins **Diamondhead Ventures**, Menlo Park, where he will look for opportunities to commercialize infrastructure technologies emerging from corporations and universities.

Of particular relevance is Mr. Russell's alma mater, Carnegie Mellon University. Mr. Russell is a founding member of the Pittsburgh school's new West Coast campus, and Carnegie Mellon's research fits well with Diamondhead's areas of interest. The firm has committed about two-thirds of the $140 million debut fund it raised in 2000, and is hoping to launch a new fund sometime this fall, Mr. Russell said.

Also contributing to Mr. Russell's decision to join Diamondhead is that the firm is looking to beef up its early-stage enterprise software practice; Mr. Russell managed corporate technology for years at several large financial institutions, including what is now Warburg Pincus.

In one of its most recent investments, Diamondhead joined **Mayfield,** Menlo Park, and **Stanford University** in a $6 million first round in June for **Orative Inc.** The Menlo Park company is developing software designed to enhance the performance of mobile phones.

Among the companies that Mr. Russell backed while at Mobius were SupportSoft Inc., a developer of business infrastructure software, and e-commerce company Buy.com Inc., both of which went public in 2000.

Greg Prow, Mobius's chief operating officer, said that his firm has no immediate plans to replace Mr. Scott. "When we raise a new fund in the next year, year-and-a-half, we'll probably revisit what we want to do," he said.

Reach Diamonhead at (650) 233-7526.

Pacific Venture Partners brings aboard **Christopher Chu** as a general partner in its Redwood City, Calif., office. Mr. Chu spent the past two years as a principal at **Crescendo Ventures**, Palo Alto, where he backed one semiconductor company and one wireless equipment manufacturer.

The move beefs up the Silicon Valley presence of Pacific Ventures, which over its 13-year history has been active primarily in East Asia, where it maintains offices in China, Taiwan and Singapore. Laurie Wang, formerly of Goldman Sachs, was brought on as a general partner to establish the Redwood City office last year. The office also includes a principal and an associate.

Mr. Chu plans to look to help semiconductor and microelectronics companies take advantage of opportunities in Asia by making use of Pacific Venture Partners' vast network.

The firm, which raised a $355 million fund in the third quarter of 2000, is looking toward launching a new fund in the second half of next year. Companies backed recently include **Spreadtrum Communications Inc.**, a Sunnyvale, Calif, wireless integrated circuit maker, and Taiwanese chipset manufacturer **Silicon Data Inc**.

Crescendo Ventures, whose current fund, closed in March 2000, totals $650 million, is not recruiting a replacement for Mr. Chu, according to a company spokeswoman. The two companies he backed while at Crescendo are semiconductor maker **Morphics Technology Inc.**, Campbell, Calif., and wireless communications equipment manufacturer **Ensemble Communications Inc.,** San Diego.

» **Douglas M. Schmidt,** a former partner at **Grotech Capital Partners,** Timonium, Md., returns to investment banking with his own firm, **Chesapeake Capital Consultants Inc.** Based in Bethesda, Md., the bank specializes in assisting middle-market technology companies. Besides advising them on mergers, equity financings and other transactions, Chesapeake also offers technology and business development consulting.

Mr. Schmidt said he is looking to assist Mid-Atlantic companies whose investors don't really understand the technology they've backed. Midsize companies need hands-on problem solvers, not a team of experts to study the situation, he said. "Investors are demanding a much higher level of management and operational fundamentals out of a company, and therefore today's investment bank has go to work with companies," Mr. Schmidt said.

Reach Chesapeake at (301) 469-3180.

» **Oak Investment Partners,** Westport, Conn., which sees India as a resource that can speed the development of technology companies, hires Oracle Corp.'s vice president for India operations. As a venture partner, **Ranjan Chak** will help Oak portfolio companies tap India's tech talent as well as look for investment opportunities.

» **Jerusalem Venture Partners** adds two venture partners to boost its software expertise. They are **Alex Ott,** a former Siebel Systems and SAP executive, and **Haim Kopans,** co-founder of Precise Software Solutions. Mr. Ott will work out of the Jerusalem firm's New York and London offices. Mr. Kopans is based in Jerusalem. JVP also adds **Hiroshi Ikegaya** as a venture partner in charge of its Tokyo business-development office. He was previously with Jafco and Mitsubishi Corp.

FUND MONITOR

YankeeTek Boosts Fund Target to $175 Million

Here's something unusual—a venture firm *raising* its target for a second fund.

YankeeTek Ventures, a Cambridge, Mass., firm that more than a year ago set out to collect $120 million, has boosted that goal to $175 million, according to Senior Managing Director Howard Anderson. The reason, he said, is a shift in focus to include not only technology startups but also buyouts and spin-outs of security companies. These would be companies with a government contract or ones looking to commercialize security technology developed for the government.

In Mr. Anderson's view, venture firms need to adjust their strategies because of the length of time it takes to build a communications or software startup to a company with $100 million in sales—large enough to command attention in the public markets. Companies that already have customers are a better bet, and the government, as the single-largest buyer of technology, is an excellent one, Mr. Anderson said.

YankeeTek Ventures Fund II, L.P., also will be aimed at technology springing from universities, as was its $60 million predecessor. Mr. Anderson, founder of research firm Yankee Group, teaches at the Massachusetts Institute of Technology. YankeeTek has backed 17 companies through its first fund, according to VentureOne. Four have been acquired, four are out of business. Remaining portfolio companies include battery developer **A123 Systems Inc.,** Boston, and **Egenera Inc.,** Marlborough, Mass., which sells servers for corporate data centers. The firm has enough capital left in its 2000-vintage fund for one or two more new investments, Mr. Anderson said.

With its second fund, YankeeTek will be looking for deals off the beaten track. It has moved Managing Director Tim Kraskey to Minneapolis to cover the Midwest. It plans to add a principal in Washington, D.C. Jack Genest, formerly with **Summit Partners,** Boston, is the firm's third managing director.

Reach YankeeTek at (617) 250-0500.

Sherpa Partners LLC has kept its eyes on early-stage companies in the upper Midwest, a strategy that it expects will help it draw limited partners for its second fund.

The Minneapolis firm has set a target range of $15 million to $30 million for **Sherpa Trek II, L.P.,** and looks for a first close by the end of the summer, according to Partner Richard Brimacomb. It closed its prior fund in 2001 at $17 million and has used it to back seven technology and health care companies.

Sherpa has yet to realize any exits. But according to Mr. Brimacomb, a $3 million fund raised by the firm's managing partner, C. McKenzie "Mac" Lewis III, while he was managing partner of Minnesota Management Partners, has returned $9 million so far.

Mr. Brimacomb also pointed to two significant investments in Sherpa's current portfolio, **Bermai Inc.** and **Unlimited Scale Inc.**

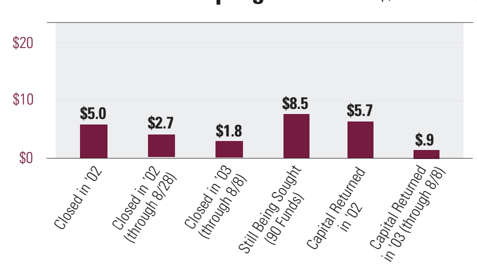
Bermai, a Palo Alto maker of chips for wireless networks, has raised $34 million, $12 million of that in a Series B round in June. The company's other backers include **Advanced Technology Ventures,** Waltham, Mass., **Mobius Venture Capital,** Palo Alto, Calif., and **Walden International,** San Francisco. Bermai's technology was developed at the University of Minnesota and the technical team remains in the state.

Unlimited Scale, Eagan, Minn., is developing a Linux operating system to run business applications. Unlimited Scale is about to complete a new round of financing.

Rounding out the Sherpa team is Partner Steven Pederson. Reach the firm at (952) 942-1070.

The IT Fund Monitor

How 2002 Stacks Up Against 2003 ($ in billions)



Includes European, Canadian and Israeli funds and all geographical focuses

Notable Closed Funds ($ in millions)

	Target	Closed in '03	Total Closed
Edison Venture Fund V, L.P. Edison Venture Fund *Lawrenceville, N.J.*	$150.0	$22.0	$142.0
ITU Ventures WEST I, L.P. ITU Ventures *Beverly Hills, Calif.*	40.0	73.0	80.0
PolyTechnos Venture Partners II PolyTechnos Venture-Partners *Munich, Germany*	—	13.1	138.1

VENTURE CAPITALIST PROFILE

McNamee Sees Room for More in Buyout Space

Silver Lake Founder Envisions a 'Venture Private Equity Industry'

Roger McNamee, who helped establish **Silver Lake Partners,** the first buyout firm formed to invest exclusively in technology deals, sees room in the field for more additional players.

"Because technology is so pervasive and its segments are so huge, I think it'd be helpful if there was a development of a venture private equity industry," says Mr. McNamee, co-founder of **Integral Partners,** the Menlo Park firm with ties to **Kleiner, Perkins, Caufield & Byers** that sponsored Silver Lake when it was formed in 1999. "I look at this space, and I can't imagine that it'll just be us."

In recent months, a number of early-stage venture firms have had a hand in technology buyouts (see story on page 1), and the interest among VCs in such deals may have something to do with the success that Silver Lake and its co-investors have enjoyed since acquiring hard-drive manufacturer Seagate Technologies in 2000. On paper, Silver Lake has generated a $1.5 billion profit since the company went public last year, and now stands to gain further from the spin-out of Seagate unit Crystal Decisions. A French business-reports software company, Business Objects S.A., has agreed to acquire Crystal Decisions for $820 million in cash and stock.

Mr. McNamee is careful to note, however, that buyout deals are by no means easy to structure. "Six of [Silver Lake's] nine investments have worked out great," he says. "But the amazing thing is how hard it is to get a transaction done in this business. They take months. They fall through. You say, 'Now what?' It keeps you honest."

Since raising $2.3 billion in 1999—more than twice its initial target—Silver Lake has put roughly $1.3 billion to work in its nine deals. The basic approach, says Mr. McNamee, is to "focus on market leaders in established categories of technology where the management team has a plan of transformation that investors are not excited about. Our mission is to help those companies achieve their dreams by removing whatever impediment they face and then moving forward on a very constructive program."

Of course, identifying what has as-yet-unlocked potential is the trick. In the case of Crystal Decisions, says Mr. McNamee, the company was clearly "an orphaned business inside Seagate. You can imagine it wouldn't have gotten the attention it has unless we did the buyout and the Seagate guys could focus on the disk drive business, though."

Of the three Seagate deals that haven't worked out so well, he says, "The one that cost us was SubmitOrder.com," a now-defunct company which Silver Lake first backed in a $75 million first round in December 1999. "We made a bunch of mistakes," Mr. McNamee says. "We had the wrong CEO, we over-capitalized the business, our customers did a lousy job of forecasting and we paid too much attention to them."

Much has changed in the technology industry, of course, since the dot-com era. In Mr. McNamee's view, the most important difference is that "the '90s were about sectors and momentum. Back then, owning number three of anything was fine."

Yet there are a still a number of what Mr. McNamee describes as growth areas. "I expect more surges out of the cell phone industry, which has been artificially slowed by business models and the regulatory climate," he says. "I think ERP [enterprise resource planning] will have another day in the sun. And I think the reality is that wireless—voice and data—is still a growth business."

Mr. McNamee started his career as an analyst at T. Rowe Price, and in 1988 began co-managing the firm's Science and Technology fund. Along with John Powell, Mr. McNamee formed Integral Capital Partners in 1991 as a vehicle for making investments in both private and publicly held companies.

The firm was launched with the support of Kleiner Perkins, which, according to Mr. McNamee, has essentially the same relationship to Integral as Integral does to Silver Lake. (All three firms are based in Menlo Park.) For the past two years, Mr. McNamee has not been involved in the day-to-day management of Integral, which remains active under the direction of Mr. Powell and other partners.

Roger McNamee

Co-founder | **Silver Lake Partners** *Menlo Park*

Employment: Co-founder, Integral Capital Partners; Fund manager T. Rowe Price Associates

Education: Yale University; M.B.A., Dartmouth College

SELECT PORTFOLIO COMPANIES

» **Flextronics International Ltd.** *Singapore*
Silver Lake invested $200 million earlier this year

» **Gartner Inc.** *Stamford, Conn.*
Silver Lake invested $300 million in 2000

» **MCI Group** *Clinton, Mass.*
Silver Lake invested $177 million earlier this year in bankrupt telephone carrier WorldCom

DEAL WATCH : SOFTWARE

JVP, Apax Back Bristol's New Software Product

Bristol Technology Inc., which is reinventing itself as a transaction-monitoring company after years of legal wrangling with Microsoft Corp., has raised $9.1 million from **Jerusalem Venture Partners** and **Apax Partners.**

The Danbury, Conn., company, founded in 1991, used to make tools for running Windows applications under Unix. Its new funding will be used to ramp up sales and market its newest product, called TransactionVision.

The software ostensibly enables customers to analyze individual business transactions consisting of numerous electronic messages between separate applications across program, platform, institutional and geographic divides. Part of the idea is to empower users to quickly discover performance failures, as well as their root causes.

Notable Software Deals

» **Revivio Inc.** *Lexington, Mass.*
Round: $20.7 million second round
Industry Segment: Database Software
Investor: Globespan Capital Partners*, Bessemer Venture Partners, Charles River Ventures, CommVest, Flagship Ventures

» **Intelliden Corp.** *Colorado Springs, Colo.*
Round: $12.5 million third round
Industry Segment: Connectivity/Communications Tools
Investors: Westbury Partners*, 3i Group, Matrix Partners, Mortonsgroup

» **Solosoft** *Mountain View, Calif.*
Round: $12.0 million later round
Industry Segment: Connectivity/Communications Tools
Investors: Carlyle Group*, Credit Lyonnais Private Equity, LogiSpring Management Co., Rothschild Asset Management

» **Monterey Design Systems** *Sunnyvale, Calif.*
Round: $10.2 million later round
Industry Segment: Design-Automation Software
Investors: Lucent Venture Partners, Rho Ventures, Sevin Rosen Funds, U.S. Trust Private Equity, Vertex Partners

» **InQuira Inc.** *San Bruno, Calif.*
Round: $9.3 million second round
Industry Segment: Database Software
Investors: Sutter Hill Ventures*, Bank of America, Partech International, Walden International

» **Addamark Technologies Inc.** *San Francisco*
Round: $9 million second round
Industry Segment: Database Software
Investors: Canaan Partners*, Battery Ventures, Sierra Ventures

*Lead investor.

TransactionVision is being marketed to transaction-heavy markets like financial services, telecommunications and insurance. Customers include American Express Co., Deutsche Telekom AG, Dresdner Bank Corp., and, most recently, the National Account Service Company LLC, which processes assorted transactions for Blue Cross Blue Shield.

"Think of Fed Ex," CEO Keith Blackwell said of his company's new product. "TransactionVision tracks the flow of business transactions, be it a stock trade or a wire transfer or an insurance claim, from each step of the process from its inception to its final destination."

Evangelos Simoudis, an Apax general partner, said that his London-based firm began looking about six months ago at companies that meet businesses' need "to monitor systems that are very distributed." Of the five or so companies that Apax examined, Bristol was the most attractive, Mr. Simoudis said. "It really was the most comprehensive in addressing this end-to-end. Bristol provides analytics that allow business and IT executives to get valuable data and communicate with one another. It can also do root analysis when something goes wrong."

In a sea of transaction monitoring companies, Bristol stood out to Jerusalem Venture Partners too. JVP, which is based in Jerusalem but has offices in New York and London, also was an investor in Precise Software Solutions, Bristol's most direct competitor. Haim Kopans, a co-founder of Precise Software, is now a JVP venture partner.

"Precise was hugely successful for us, and with Haim on board, we felt like we had an even better overview of the space and what it was we were looking for. Bristol's technology was it," said Allen Bloch, a JVP principal.

(Precise Software, which went public three years ago, now is part of Veritas Software Corp. Veritas acquired the company in July for $609 million in order to integrate Precise's application performance management software into its own storage-focused software portfolio.)

Despite its 12-year heritage, Mr. Bloch regards Bristol as an early-stage company, given its revised strategy and relatively few customers. "Acquisition is always an option," Mr. Bloch said, "but you can't plan for a company to be bought. We build companies for IPOs. Those are the marching orders right now."

In Bristol's prior iteration, making toolsets that included Windows code licensed from Microsoft, the company found itself in a three-year lawsuit with the software giant beginning in 1998. The suit was settled when Microsoft agreed to pay legal fees and damages to Bristol in an undisclosed settlement.

DEAL WATCH : COMMUNICATIONS

Fresh Backing for a Pair of Telecom Survivors

As communications giants start looking for cheaper ways to deploy services such as video conferencing and robust storage networks, venture firms are sinking more money into startups like **Atrica Inc.** and **Native Networks.** The two are attacking metro-network markets with Ethernet technology, but with different strategies: Native is teaming up with OEMs; Atrica is going it alone.

Both are survivors, having so far weathered the telecom tailspin. Atrica, based in Santa Clara, Calif., is larger and has raised far more capital, but Native Networks, which has its headquarters in the London suburb of Maidenhead and its engineering team in Israel, has Alcatel in its corner.

Native recently closed an $11.5 million third round led by returning investor **Jerusalem Venture Partners,** Jerusalem, and new investor **Israel Infinity Venture Capital,** Tel Aviv. The company, started in 1999, has raised $40.5 million. Other investors include **Alta Berkeley Venture Partners** and **Apax Partners,** both of London, **Israel Seed Partners,** Jerusalem, and **Soros Fund Management,** New York.

Native's relationship with Alcatel was key to its new round, according to JVP General Partner Laurel Bowden. The French telecommunications-equipment maker announced in February that it was partnering with Native Networks to speed the introduction of more sophisticated metro Ethernet features into Alcatel's next-generation equipment.

"That Alcatel OEM is absolutely critical for Native," Ms. Bowden said. "It immediately puts the product on the map. It immediately gives us enormous credibility." Native is hoping to ink another original-equipment manufacturing deal by the end of the year, which the Alcatel partnership helped Native land. Native's product works alongside carriers' existing equipment, allowing them to offer Ethernet connections over existing synchronous optical networks, known as SONETs. Most of Native's customers are in Europe and Latin America, but it plans to open a U.S. office within 18 months, Ms. Bowden said.

Atrica has raised more than three times as much as Native Networks, but William Cadogan, the **St. Paul Venture Capital** general partner on Atrica's board, said the company is "on the right kind of growth trajectory," with revenues next year projected to be $65 million to $70 million, compared with $25 million this year.

Mr. Cadogan said Atrica has done some small partnerships with other equipment makers "but by and large, Atrica is of a size where they can probably go it alone." Although carriers are often wary of buying from startups, Mr. Cadogan said, "If startups offer something unique that they can't get from anywhere else, then they will move forward and deal with the companies."

Atrica, spun out of 3Com Corp. three years ago, sells a hub box that sits at a carrier's central office and devices that are placed at business premises that can provide services such virtual private networks and access to data storage. The system can work with SONET, but mainly is a replacement for it, Mr. Cadogan said. The company is selling most of its product in Asia but expects to boost sales in Europe and the United States.

Atrica's $17 million fourth round brought its total financing to $134 million. Mr. Cadogan said the opportunity is large enough to make the continued investment in the company worthwhile. Besides St. Paul, based in Eden Prairie, Minn., investors include **Ascend Technology Ventures,** Ramat Gan, Israel, **Accel Partners,** Palo Alto, **Benchmark Capital,** Menlo Park, **Intel Corp.,** Santa Clara, and **JK&B Capital,** Chicago.

Mr. Cadogan said metro networks, which link corporate offices in metropolitan areas, represent one of the few hot spots in the communications industry and that Ethernet technology is nibbling away at the SONET market share because it is a cheaper way to move data. "This is probably one of the few spaces where you want to put some money," he said.

But VCs should be careful. The communications sector is not out of the woods, and U.S. carriers are still not snapping up next-generation technology, even for metro networks. Said James Slaby, an analyst at Forrester Research, "In the near term, pending the recovery, you're going to see fairly modest growth in this space."

Notable Communications Deals

» **Airespace Inc.** *San Jose*
Round: $22 million second round
Industry Segment: Wireless Communications Equipment
Investors: Fidelity Ventures*, Battery Ventures, Norwest Venture Partners, and others

» **Matrics Inc.** *Columbia, Md.*
Round: $20 million second round
Industry Segment: Wireless Communications Equipment
Investors: Carlyle Venture Partners, Novak Biddle Venture Partners, Polaris Venture Partners, and others

» **ASIP Inc.** *Somerset, N.J.*
Round: $16 million third round
Industry Segment: Fiber-optic Equipment and Photonics
Investors: Nokia Venture Partners*, Finaventures, Intel, Redpoint Ventures

* Lead investor.

VENTURE FIRM PROFILE

Fidelity Ventures Offers Window on a Wide World

Parent Company's Huge IT Staff, Client Roster Among Firm's Biggest Assets

With everyone in the venture world looking for insight into the technology needs of big corporations, startups dream of having a window into a giant like **Fidelity Investments,** the largest mutual fund company in the United States.

Wireless equipment maker **Airespace Inc.** found that portal when it began wooing the investment firm as a customer only to find that Fidelity's technology venture unit had been watching it.

Fidelity Ventures led a $22 million second round for the San Jose company in July. For Airespace, the deal represented "a validation of the opportunity" for its technology and a chance to tap into "one of the premier IT shops in the world," said Brett Galloway, the company's president and CEO.

Based in Boston, the home of its parent, Fidelity Ventures is older than most venture firms, tracing its roots to 1969. Its early portfolio companies included Atari, Continental Cablevision and MCI.

The firm manages a series of funds on behalf of Fidelity Investments, drawn from retained corporate earnings and employee capital. The latest, supplied in 2001, totals $250 million. While it is closely attuned to the IT needs of its sponsor, Fidelity Ventures functions much like **St. Paul Venture Capital** and **Norwest Venture Partners,** independent venture firms financed by St. Paul Venture Capital and Wells Fargo, respectively. The primary goal of Fidelity Ventures, which specializes in communications and corporate IT, is to realize venture-like returns.

With four partners, one of them in London and the rest in Boston, Fidelity Ventures looks to do three or four new technology deals this year. (**Fidelity Biosciences Group,** a new Fidelity unit formed to invest in health care, is a separate entity.)

Fidelity Ventures showed restraint during the tech boom, making just five new U.S. investments in each of 1999 and 2000, according to VentureOne. The firm—building capacity to do eight to 10 new deals a year if the opportunities arise—recently added Dave Power, formerly of **Charles River Ventures,** Waltham, Mass., as a partner and might add another.

"We see industry consolidation," said Rob Ketterson, the firm's managing partner, "and our focus is on shoring up our market position in a down time." Mr. Ketterson said Fidelity Investments has a long-term commitment to venture capital. "It is a fabric of Fidelity's own business to be entrepreneurial," he said. Furthermore, "there is plenty of private equity available from the sources that we tap."

Fidelity Ventures usually invests in first or second rounds of companies that have begun to ship product. The firm looks to provide what it calls "go-to-market capital."

"We're really stage-independent, but the center of gravity is really around companies going to market," Mr. Ketterson said. Fidelity Investments, in addition to providing insights into the needs of large enterprises, also gives the venture firm a global reach and an understanding of capital markets that can be helpful to companies seeking to be acquired or go public, he said.

A Two-Way Street

Airespace illustrates how Fidelity Ventures sources deals and how it collaborates with the Fidelity Investments IT team.

The company, founded in 2001, has developed wireless equipment that businesses ranging from midsize to huge can use to give workers moving about an office, hospital or factory access to their local area network. One of its earliest customers was Duke University Medical Center, whose staff carries personal digital assistants to access hospital records.

After drawing $500,000 in seed money from **Storm Ventures,** Palo Alto, Airespace collected $15 million last year in a first round that also included **Battery Ventures,** Wellesley, Mass., and Norwest. Eager to crack the financial services market, Airespace was in touch with Fidelity Investments' IT shop. Meanwhile, Fidelity Ventures was looking at wireless LANs.

The venture firm had been evaluating the sector for about a year, working closely with technology experts at the mutual funds company who were trying to overcome shortcomings of

At a Glance

Fidelity Ventures

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Simon Clark | Partner

VENTURE FIRM PROFILE

existing technology. To facilitate this kind of collaboration, Fidelity Ventures has a business development specialist, James Smith, whose job is to communicate with the thousands of IT professionals at Fidelity Investments. "We seek out the leaders in spaces that are interesting and where we can add value," said Mr. Ketterson. "It's a two-way street for sure."

From its research, Fidelity Ventures saw the need at large enterprises across many industries for a more scalable, manageable wireless LAN, said Partner Anne Mitchell. It then looked at the vendors and decided that Airespace met the product requirements, she said.

And the timing was right for Fidelity Ventures to invest. "They really are at the state where they are looking at execution and bringing the product to market," Ms. Mitchell said.

Mr. Galloway, the CEO, said Airespace had planned to raise $15 million to $20 million once its product was ready, but let the round creep up to $22 million, which should finance the company to break-even. The valuation, he said, was significantly up from the $22 million post-money price in the first round—he wouldn't say how much—and the deal terms "were hyper-clean," even better than the first round.

The deal brought Airespace introductions to other large enterprises and potential partners and access to customer requirements and needs. It also got the company some much-desired attention. "We need to be mindful of ways to rise above the crowd," Mr. Galloway said.

But Fidelity Investments is not a customer and will not be unless Airespace proves itself. "We have product there," Mr. Galloway said. "It's very early."

Mr. Ketterson said that while there is some interaction between portfolio companies and Fidelity Investments most of the time, a majority are not customers. He said he tells companies not to expect Fidelity to be a customer and a reference.

One company to which it was both of these is Geotel Communications, a developer of call-center software that went public in 1996. Fidelity Ventures led its third round. Other backers included **Atlas Venture** and **Matrix Partners,** both of Waltham, Mass., and **New Enterprise Associates,** Baltimore.

When a venture firm it knows well is involved, Fidelity Ventures will invest in seed-stage deals, as it did with **Fabric7 Systems Inc.,** Mountain View, Calif., a New Enterprise Associates project. The company, which is still playing its cards close to its vest, is working on server technology for data centers; NEA wanted Fidelity on board early to help with product specifications, according to Mr. Ketterson. After its $500,000 seed round in May 2000, Fabric7 raised a $14 million first round from Fidelity Ventures, NEA and **Goldman Sachs Group,** New York.

NEA and Fidelity have backed another company working on data-center server technology, **Newisys Inc.,** Austin, Texas. The company's servers address the high cost of Unix-based data centers, said Mr. Ketterson, who is on the board. Data-center operators such as Fidelity Investments want more commodity hardware running Linux applications, he said. Newisys's server is based on **Advanced Micro Device's** Opteron processor. AMD is an investor in the company. NEA and **Austin Ventures,** Austin, were first round backers; Fidelity led the $25 million second round last October.

Another recent Fidelity Ventures deal was a follow-on investment for a Bloomfield, N.J., company that it first backed in 1998—**Evident Software Inc.,** formerly Apogee Networks. The company raised a $6.4 million fourth round from its long-time backers, Fidelity, **Granite Ventures,** San Francisco, **Intel Corp.,** Santa Clara, Calif., and **Oak Investment Partners,** Westport, Conn.

Evident's technology allows large corporations to measure the cost of their IT usage. This is essential to two trends—outsourcing IT services, and distributed or utility computing, in which enterprises buy computing capacity as needed from outside suppliers, said Ms. Mitchell, a member of the Evident board. "You can almost say that the enterprise needs have caught up to what Evident has."

Investment Snapshot

Companies Backed Since 1997	**37**
Public	3
Acquired	9
Out of Business	4

Breakdown by Sector	
Software	20
Communications	6
Consumer/Bus. Services	5
Information Services	4
Electronics	1
Semiconductors	1

Breakdown by Rounds	
Seed	1
First Round	12
Second Round	24
Later Stage	22

Minimum Investment: $1 million

Maximum Investment: $10 million

Number of Investments in 2002: 9 (4 new)

Number of Investments This Year: 4 (1 new)

Current Fund: $250 Million (Closed in May 2001)

Capital Left to Invest: $170 million

Next Fund: 2005

Source: VentureOne

CORPORATE VIEW

Corporate Clients Will Help Set Tellabs' Acquisition Pace

With $1 billion in cash and no debt, **Tellabs Inc.** could emerge as a savior for venture firms with struggling telecom equipment startups.

But whether the Naperville, Ill., maker of optical networking systems, broadband access systems and voice-quality enhancement systems significantly accelerates its pace of acquisitions—since early 2001 it has made just three—depends in large part on its corporate customers.

Tellabs seeks to meet the particular needs of major telecom carriers, as well as supplying products that might generate additional dollars, said Greg Nulty, who as senior vice president of strategic planning helps direct the corporation's acquisition and investment activities.

"The more healthy they are, the more healthy we are," Mr. Nulty said. "We are looking for opportunities where the customer sees revenue opportunities or product voids."

Mr. Nulty and his team will be talking to industry contacts, including VCs and investment bankers, to get a handle on companies that may be developing attractive products. But they also will be consulting with Tellabs' own staff to gain a feel for the cost and time of developing such products internally.

The key question is one of time. If a product is close to Tellabs' expertise and can be developed quickly, Tellabs is likely to try to do the work itself. But if the anticipated amount of time and money spent on the product's development is judged significant, then Tellabs will be much more likely to move toward an acquisition.

This was the case early this year, when Tellabs agreed to pay $135 million in cash and stock for Vivace Networks, a San Jose developer of next-generation optical sensing switches for carriers. Vivace, established in 1999, had secured close to $120 million in three rounds from investors including **Foundation Capital, J.P. Morgan Capital, Redpoint Ventures** and **Sutter Hill Ventures.**

Tellabs, according to Mr. Nulty, had realized that its customers needed to be able to create multi-service Internet protocol networks, which allow users to handle legacy systems as well as deal with technical advancements. "When we took a look at all our criteria, Vivace seemed to be the best fit," Mr. Nulty said.

Tellabs' previous acquisition came in January 2002, when it paid $355 million for Ocular Networks, a Reston, Va., developer of optical network equipment that counted **Bessemer Venture Partners, Columbia Capital** and **Highland Capital Partners** among its venture backers. Almost a year earlier, Tellabs acquired Future Networks, a developer of standards-based voice and data cable model technology. **Cisco Systems Inc.** was among the backers of the Alpharetta, Ga., company, for which Tellabs paid $181 million.

Less Pressure to Buy

With the telecom industry still struggling, Tellabs is being "a lot more cautious" about acquisitions than it was a few years ago. (Mr. Nulty himself came on board as a result of the acquisition of Ocular Networks, where he was vice president for business development.) The pressure to compete against other telecom equipment companies for a deal is no longer as intense, he said.

"Every case is different, but we're obviously doing a lot of due diligence when looking at these companies," Mr. Nulty said.

Tellabs also has played a role as a venture investor. It holds a stake, for example, in **White Rock Networks,** a Richardson, Texas, developer of public networks. The company, which is shipping product, has raised more than $150 million from a large group of investors including **Mayfield, Meritech Capital Partners, Oak Investment Partners** and **Cypress Semiconductor.**

A venture investment by a corporation can sometimes be the harbinger of an acquisition. According to Mr. Nulty, a Tellabs' investment makes an eventual acquisition more ikely, though he did not cite any cases where that has been the case.

In making a minority investment, Tellabs weighs many of the same factors it does in making an acquisition, most notably what is the quickest way for Tellabs to serve its customers.

"I would characterize us as having an open mind," Mr. Nulty said. "We'll use our full bag of tricks, internal development, external investing and M&A."

At a Glance

Tellabs Inc.

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Greg Nulty | Senior Vice President of Strategic Planning
Email: Greg.Nulty@tellabs.com

THE LIST

Audit Firms Whose Technology Clients Raised Venture Capital*

Firm	Contact Information	Contact Person	Clients Getting Funding
Ernst & Young 5 Times Square New York, NY 10036	www.ey.com ph: 212-773-0335 fax: 212-773-7982	Gil Forer Venture Capital Advisory Group	198
PricewaterhouseCoopers 1301 Avenue of the Americas New York, NY 10019	www.pwcglobal.com ph: 646-471-4000 fax: 646-394-1301	Mike Ascolese Audit, Accounting & Risk Management ph: 201-521-3000	187
Deloitte & Touche LLP Corporate Finance Group, 1633 Broadway, 10th Floor New York, NY 10019	www.deloitte.com ph: 212-489-1600 fax: 212-492-4154	Mark Jensen National Director, Venture Capital Services	123
KPMG 530 Chestnut Ridge Road Woodcliff Lake, NJ 07677	www.kpmg.com ph: 201-505-3400 fax: 201-505-3404	Mark C. Terrell Partner, Audit Committee Institute	86
RBG & Co. N. Brentwood Blvd. St. Louis, MO 63105	www.rbg.com ph: 314-290-3300 fax: 314-290-3400	James G. Castellano Managing Partner	21
Grant Thornton LLP 175 W. Jackson Blvd., 20th Floor Chicago, IL 60604	www.grantthornton.com ph: 312-856-0001 fax: 312-565-4719	Michael C. Hall Managing Partner	9
BDO Seidman LLP 130 E. Randolph St., Suite 2800 Chicago, IL 60601	www.bdo.com ph: 312-240-1236 fax: 312-240-3311	Dennis Fusco Director, National Assurance ph: 617-422-0700	6
Frank, Rimerman & Co. LLP 2882 Sand Hill Road Menlo Park, CA 94025	www.fr-co.com ph: 650-854-3344 fax: 650-854-2234	Bryan Polster Managing Partner	4
Mohler Nixon & Williams 635 Campbell Technology Parkway, Suite 100 Campbell, CA 95008	www.mohlernixon.com ph: 408-369-2400 fax: 408-879-9485	Bud Fallon Owner & Director, Auditing Group	4
Hughes Pittman & Gupton 3110 Edwards Mill Road, Suite 210 Raleigh, NC 27612	www.hpgcpas.com ph: 919-787-9765 fax: 919-787-9384	Tim C. Gupton Partner	2
McGladrey & Pullen LLP 3600 American Blvd., W., Third Floor Bloomington, MN 55431	www.mcgladrey.com ph: 952-835-9930 fax: 952-921-7702	Brian Schebler Partner	2

* From Sept. 1, 2002 to July 31, 2003.

FROM THE FRONT

Venrock Team Shrinks Further

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Helfrich (*Venture Capital Analyst-Technology,* August, page 2).

Mr. Hathaway, who according to Managing General Partner Ray Rothrock has retired after 24 years at the firm, was vacationing with his family and could not be reached for comment. Mr. Casey, who joined Venrock in April 2000 and works from its Cambridge, Mass., office, said only that he would be remaining with Venrock through the end of the year.

The changes at Venrock are a reminder that prominent technology firms are still dealing with the aftermath of the technology boom. A number of firms that beefed up their staffs in order to take advantage of Internet or telecom deals have since taken steps to bring the size of their teams more in line with a slower investment pace and smaller anticipated funds.

Palo Alto-based **Technology Crossover Ventures,** according to sources, is considering reducing the size of its team as it prepares to raise a successor to the $1.7 billion fund it assembled in 2000 (*Venture Capital Analyst-Technology,* August, page 2). Late last year, **Battery Ventures,** Wellesley, Mass., announced that it would be cutting nine positions from its 55-member staff, including two general partners who specialized in communications deals.

The four departures at Venrock leave the New York-based firm with a total of five technology investors: Mr. Rothrock, fellow Managing General Partner Tony Sun, and General Partner Eric Copeland in Menlo Park; General Partner Mike Brooks in New York; and General Partner Mike Tyrell in Cambridge.

The firm also has two health care investors, Managing General Partner Anthony Evnin, and General Partner Bryan Roberts. The ratio of five technology partners to two health care is more in line with Venrock's typical practice of investing about three-fourths of its capital in technology, and one-fourth in health care.

'Venrock Will Continue to Be Venrock'

Mr. Rothrock, who had previously confirmed that Venrock intends to raise a new fund this year, declined to elaborate on plans for the fund. Sources, however, say the firm is looking to close the fund by early next year.

Asked if Venrock plans any change in investment strategy, Mr. Rothrock said, "At this time, I and none of the folks here can comment about the particulars. Suffice it to say at this time, Venrock will continue to be Venrock in its strategy, style of investing and energy going forward."

Venrock, established as the venture arm of the Rockefeller family in 1969, through last year had retained a fairly steady pace as a technology investor, despite the general slowdown in the sector (*Venture Capital Analyst-Technology,* February, page 14).

Of late, the firm has been looking to back security, wireless and networking companies. Recent investments include ones in **WebCohort Inc.**, Ramat Gan, Israel, a developer of database security software that raised $12 million in a second round in early June; and **Starback Communications Inc.,** Waltham, Mass., a multimedia networking software company that in July raised $3 million, also in a second round.

The firm's overall record in technology investing is an impressive one. Of the 154 IT companies it has backed since the early 1980s, usually at an early stage, 45 have gone public, according to VentureOne. They include Check Point Software Technologies Ltd. and DoubleClick Inc.

While Venrock has been making investments for more than 30 years, it did not draw capital from outside the Rockefeller family until 1995, when it assembled a total of $252 million for **Venrock Associates II, L.P.** In addition to the $657 million fund closed in 2000, with **Harvard University** and **Massachusetts Institute of Technology** among is limited partners, Venrock also is investing $150 million on behalf of the Rockefeller family itself.

By Constance Loizos
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FROM THE FRONT

Some VCs Mulling Buyout Deals

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manufacturer went public, investors are set to further profit on the spin-out of data storage software unit Crystal Decisions, which the French company Business Objects SA has agreed to purchase for $820 million.

Nonetheless, some investors question whether it is wise for VCs to move beyond what they already know how to do. While some firms, including Oak and, to a lesser extent, Battery, have been involved with buyouts in the past, of the venture firms mulling such opportunities are early-stage specialists.

"Obviously, there's been a general consolidation in the market, creating fewer exit opportunities—all while a lot of money sits on the sidelines," says Evangelos Simoudis, a general partner of **Apax Partners**, a London-based firm that invests in both early-stage deals and buyouts. "But VCs looking to put money to play via a late-stage or publicly traded company can easily wind up heartbroken. The analysis that needs to be done to identify the most appropriate late-stage companies to invest in requires skill sets that VCs typically don't have."

Not surprisingly, many of the venture firms now eyeing buyouts are large ones. And while some have taken steps to reduce the size of the billion-dollar funds raised during the technology boom, a large amount of capital remains on hand—an estimated $75 billion as of this past spring, according to a VentureOne survey of U.S. firms (*Venture Capital Analyst-Technology,* April, page 1).

A reasonable question is whether what remains of the overhang is driving VCs to look for bigger deals.

David Tabors, a principal at Wellesley, Mass.-based Battery Ventures, dismisses the notion that "this is some trend born of impatience on the part of VCs to find quality deals and spend their funds.

"That's certainly not true in our case," Mr. Tabors says. "We do a ton of research that has yielded theories about maturing markets and consolidation at certain segments of the market. As parts of the market in which we have expertise mature, the types of investments we do in those markets will naturally mature as well."

Made2Manage, the Indianapolis company that Battery acquired in June (*Venture Capital Analyst-Technology,* July, page 2), "has more than 1,600 active customers and we paid $30 million," Mr. Tabors says. "You couldn't hire a sales force to buy 1,600 customers for that much capital."

Ron Nordin, a principal at Waltham, Mass.-based Atlas Venture, makes a similar point about Kalido Inc., the company that Atlas acquired with Benchmark in July. "At a time like this, the buying criteria within IT departments of companies have really tightened around things with business value. We think it's a good bet for us to look at companies that have demonstrated that their products fit into today's environment."

Unilever, the consumer products conglomerate, has more than 60 installations of Kalido's data warehousing and storage software, according to the company. Koninklijke Philips Electronics N.V. and beverage and confectionary products manufacturer Cadbury-Schweppes plc are also customers.

"There's still lots of room for new technologies in the market," Mr. Nordin says, "but there is an interest at Atlas and likely at other venture firms in companies that are really showing traction in the market. Our core proposition is still building companies from scratch, but we're skewing more investments in that [later-stage] direction."

Austin Ventures, a few months before acquiring Staktek, also of Austin, Texas, made and then withdrew a bid for publicly traded business news company Hoover's Inc., which subsequently became part of Dun & Bradstreet Corp. Partners at Austin declined to discuss the Staktek deal. But in an interview with Dow Jones Business News in early July, General Partner Joe Aragona said that Austin Ventures is prepared to pursue other such opportunities. "The fact is that if we can

FROM THE FRONT

get a venture return … we're going to be opportunistic and go after those companies," Mr. Aragona was quoted as saying.

Battery Ventures' Mr. Tabor concedes that buyout deals present complexities, particularly if the company being acquired is publicly traded. But he insists that the mechanics of the deal shouldn't influence the decision-making process.

Back When IPOs Were Easy

Many of the companies trading on Nasdaq these days probably never would have gotten there had it not been for the wide-open IPO window in 1999 and 2000. Years after going public, a good number of these companies still look and operate much like startups, with problems that can best be worked out in a private context. Roger McNamee, co-founder of the technology buyout firm **Silver Lake Partners,** Menlo Park, describes such companies as offering "transformational opportunities.

"I think the tech industry is maturing and its needs are really different than it used to be, and I believe there are a lot of flavors of investment opportunities in mature technology companies," says Mr. McNamee, whose firm was among the investors in the Seagate deal. "The industry got so bent out of shape during the '90s that it'll take a decade to clean up the mess. That's plenty of time to really build new models around private equity, and I think plenty of VCs can do it." (For more on Mr. McNamee and his approach to technology buyout investing, see profile on page 7.)

Even those who, like Martin Gagen, CEO of U.S. operations for London-based **3i Group,** maintain that "you rarely find a venture investor that's good at buyouts or vice versa," can embrace the rationale of VCs who've begun eyeing more established companies.

"Some markets have matured sufficiently such that early-stage companies aren't the right way to approach them," Mr. Gagen says. In software markets, the traditional thinking was to grow a small company's niche product quickly and sell the enterprise for a couple of million dollars or take it public, but I question if it's feasible any longer to build a world-class software company from scratch. Today, a stronger argument can be made for buying a great, established company, melding it with another, then adding a world-class tech team to help the combined outfit build a new suite of products."

3i Group itself made an uncharacteristic late-stage investment in March, joining **VantagePoint Venture Partners,** San Bruno, Calif., in a $50 million round for **SCP Global Technologies,** a Boise, Idaho, semiconductor equipment manufacturer that was founded in 1975 (*Venture Capitalist Analyst-Technology,* April, page 11).

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EXITS & ENDINGS

Tellium Deal Won't Mean an Exit for Zhone Backers

Zhone Technologies Inc., the telecom equipment maker that drew $500 million from venture capital and private equity firms in 1999, is poised to become listed on Nasdaq via the pending acquisition of a publicly held maker of optical switches.

But even if the deal to acquire **Tellium Inc.,** Oceanport, N.J., in a $180 million reverse stock swap closes as planned, the work of Zhone investors such as **New Enterprise Associates,** Baltimore, will not be done.

NEA General Partner C. Richard Kramlich and Zhone Technologies' other private equity investors will keep their board seats, "And we're very much engaged in the development of the combined companies," Mr. Kramlich said.

The deal, in addition to giving Zhone a listing on Nasdaq, will provide it with about $150 million in much-needed cash from Tellium's balance sheet. As of June 30, Zhone had less than $2 million left, according to the company's second-quarter results.

Kohlberg Kravis Roberts & Co., New York, and **Texas Pacific Group**, Fort Worth, each invested $150 million to back the startup in 1999. Other investors, including NEA, **U.S. Venture Partners,** Menlo Park, **Madison Dearborn Partners**, Chicago, and **California Public Employees' Retirement System** invested an additional $200 million in equity. Zhone's backers will own 60 percent of the combined company, which will retain the Zhone Technologies name.

Zhone's backers believe the merged company will be able to reduce its operating expenses and also be able to sell additional products to the other companies' customers. Zhone manufactures hardware and software that allow customers of large communications companies such as Bell Canada and Motorola to access bundled telephone and Internet services; Tellium produces optical switches use by Dynegy Connect, Lockheed Martin and Qwest Communications.

Both companies, however, continue to lose money. For the quarter ended June 30, Tellium posted a net loss of $12 million on revenue of $10 million, while Zhone posted a loss of $4.7 million on sales of $20 million.

But Mr. Kramlich said Zhone has a strong domestic and international presence and is approaching the break-even point. "They're moving into the black is the right way to look at this," he said.

"The main thing about this," Mr. Kramlich said, "is it gives [CEO Mory Ejabat] and his team a platform from which to grow the business."

Sequoia Capital's Michael Moritz has scored again. In early August, Sun Microsystems Inc., Santa Clara, Calif., announced that it would pay $66 million in cash to acquire Redwood City, Calif., software startup **CenterRun Inc.**, a company that Menlo Park-based Sequoia first backed in early 2001. CenterRun raised a total of $19 million from investors including **CrossLink Capital**, San Francisco, and **Needham Capital Partners**, New York.

CenterRun makes software that allows data center applications to be more easily installed on a large number of machines. Its customers include First American Corp., Kaiser Foundation Health Plan Inc. and VeriSign Inc.

Sun's acquisition of the three-year-old company is part of the corporation's effort to develop software that will unite groups of computing, storage and networking equipment into a single resource that is easy to manage and adjust to changing needs—a strategy called N1. Part of that effort aims to replace ad hoc administrative procedures like ensuring a particular software package is installed before loading another with an automated process. CenterRun's server software, according to the company, can automatically record, compare and change the configuration details of server software from nearly every major vendor, including Oracle, IBM and Microsoft.

It is the third company Sun has gobbled up in the last year for N1. Last November, it acquired storage networking start-up Pirus Networks Inc. for $167 million in stock; last November, it purchased TerraSpring Inc., a data center management software company, for $30 million in cash. Its deal with CenterRun is expected to close in September.

Notable Acquired Technology Companies*

» **DevX.com** *Mountain View, Calif.*
Select venture backers: Hummer Winblad Venture Partners
Purchase price: $3 million in cash and stock
Acquirer: Jupitermedia Corp.

» **Listen.com** *San Francisco*
Select venture backers: Altos Ventures, August Capital, Austin Ventures
Purchase price: $36 million in cash and stock
Acquirer: Real Networks Inc.

» **Netscalibur** *London*
Select venture backers: Goldman Sachs, Morgan Stanley Private Equity, TLcom Capital Partners
Purchase price: £20 million in cash
Acquirer: Claranet Ltd.

*From July 11 through August 8.