

January 2008 Cover Story



By Joanna Glasner

## Juggling Act

**With deals and exits popping up on multiple continents, VCs like Tom Blaisdell of DCM have had to become master multitaskers.**

Ask a venture capitalist how the year went, and the answer inevitably involves a reflection on the questionable relevance of 365-day increments in measuring success.

**Tom Blaisdell** is no exception. “Years are arbitrary demarcations,” says the **DCM** general partner, wrapping up a review of the firm’s 2007 exit data. “We’re betting on five-, 10-, 15-year trends.”

Nonetheless, when forced to consider industry performance in 12-month chunks, Blaisdell concedes that 2007 “was a pretty good year.”

It was a decent year for the venture industry overall, helped by a recovering IPO market, lively M&A sector and healthy fund-raising climate. VCs continued to pour dollars into cleantech, digital media, and India- and China-based startups. On the exit side, venture firms profited handsomely from a series of solid hits, including offerings by several survivors founded during the dot-com bubble.

At DCM, which expected to log 11 positive exits by the end of December, 2007 was unquestionably a standout year. Overall, the firm expects returns of about \$300 million for the year. Investments from its 1996 and 2000 vintage year funds, as well as its China-based portfolio, promise to bring the bulk of returns.

With big exits and sought-after rounds as likely to emanate from the Far East as the East Coast, it was a year suited to a veteran multitasker, accustomed to tracking technologies and cutting deals

across national boundaries. In that vein, DCM was something of a poster child for venture's global face. Partners divided new investments between East Asia and the United States and churned out exits for portfolio companies domestically and abroad. In other industries and regions—biotech and India, most notably—DCM took a lesser role or opted out entirely. Like most firms with multiple funds in play, partners found maintaining a portfolio in their core sectors to be enough of a juggling act.

## Up in the air

If there's one rule that venture capitalists follow in prepping a company for exit, says firm co-founder **Dixon Doll**, it's that: "You can never be sure what conditions are going to be like." Put that to music, and it could be the theme song of 2007.

For the bulk of VCs, squeezing out returns this year has been an exercise in both patience and quick-reflex opportunism. U.S. markets posted an unusually volatile year, with the credit crunch drying up leveraged buyout shops as a source of exit cash, and investor appetites for tech and life science offerings gyrating along with the broader indexes. Venture investors had to maneuver and change course quickly to benefit or minimize fallout in a rapidly altering investment landscape.

Tumult wasn't limited to stock markets. On the hipness front, 2007 was the year in which VCs' beloved Blackberry got brusquely upended by the iPhone as the tech set's mobile status symbol of choice. Corn-based ethanol went from much-hyped gas alternative to a fuel VCs widely consider economically unviable. And the U.S. dollar went from global reserve currency to something that will barely buy 1% of a barrel of oil.

On the entrepreneurial side, venture capitalists last year became blasé to the idea that startups operate multi-nationally from inception. "Today, it's pretty unusual for a team to come in to our office in Silicon Valley and say that all the functional activities will be in one place," observes Doll. That's mostly a good thing, he says, as hiring software developers in developing countries saves on startup costs. However, all that international exposure is having a detrimental effect on the already disrupted sleep cycles of ambitious entrepreneurs and venture capitalists.

Even traditions like the Monday morning partners' meeting have been reconfigured for the age of multi-continental portfolios. At DCM, Sand Hill Road-based partners now run their meeting from 3 p.m. till around 9 p.m. That's so their partners in Beijing—for whom the call starts at 7 a.m.—can participate.

"The fact is, the calls you need to be on come up at every hour of the day or night," says Doll, who had been on calls to Europe just before going to bed the previous night and immediately after waking up. A few days earlier, he came home from a Christmas party and immediately hopped on a 9 p.m. call for an audit committee meeting in India.

When they weren't staying up late for conference calls, U.S. VCs spent a considerable portion of 2007 on transoceanic flights. Top destinations included familiar emerging market hotspots, such as Beijing, Shanghai, Mumbai and Bangalore.

Spending in India in particular was up notably. In the first 11 months of 2007, U.S. venture capitalists poured \$1.04 billion into Indian companies, compared to \$932 million in all of 2006, according to **Thomson Financial** (publisher of *VCJ*). Fifty-seven U.S. firms were active in India last year, up from 45 in 2006.

While DCM is not actively pursuing investments in India, it continued to focus on China. In the first 11 months of the year, VCs worldwide poured \$3.18 billion into 428 Chinese companies, a dramatic increase from the \$1.77 billion they put into 324 Chinese companies in all of 2006, according to **Zero2IPO**, a Hong Kong-based research firm.

In addition to making new investments, venture capitalists generated a few exits from Chinese investments. **Spreadtrum Communications**, a wireless semiconductor developer, **Yingli Green Energy Holding Co.**, a solar cell manufacturer, and **WuXi PharmaTech**, a pharmaceutical research outsourcer, were among the China-based, venture-backed companies to go public on U.S. exchanges last year. Among the biggest exits was the \$1.5 billion IPO of Chinese e-commerce site **Alibaba.com**. Investors who held on to their shares made a nice return in November, when Alibaba nearly tripled in first-day trading on the Hong Kong Stock Exchange.

Several more Chinese companies were in registration for U.S. IPOs at year-end. One of those—IT outsourcing provider **VanceInfo Technologies**—stood to deliver a generous return for DCM, its largest venture backer. DCM owns 6.2 million shares, valued around \$60 million based on the planned offering price.

Of course, with turbulent 2007 winding a close, venture capitalists are wary of counting their exits before they hatch.

## Shifting gears

“Shifty” is a word that comes to mind for Blaisdell when he’s asked to describe the 2007 exit climate. By this he doesn’t mean evasive so much as fast-changing and difficult to maneuver. “It used to be either you prepared for an IPO, or you got bought by a strategic buyer,” he notes. Today, VCs have a half-dozen viable exchanges to choose from, as well as offers to consider from both financial and strategic buyers. ROI potential from each of those exit paths, meanwhile, fluctuates constantly, with little advance indication of how investor appetites will shift.

Earlier this year, for example, many VCs hoped the huge surge in funding for buyout investors would provide a significant source of liquidity for portfolio companies. More than 70% of the VCs surveyed in December 2006 by the **National Venture Capital Association** said they believed such exits would become a more attractive option in 2007.

DCM had already profited handsomely from one such transaction in late 2006. Buyout firm **TA Associates** bought Barcelona-based online travel agency **eDreams**, a DCM portfolio company, for \$195 million in October of that year.

Partners were optimistic that similar deals would fatten the exit pipeline in 2007, too. But that turned out to be wishful thinking. Credit market turmoil that took hold in summer put a damper

on buyout funds' appetites for venture-backed acquisitions. So M&A focus shifted back to strategic buyers—who displayed a welcome willingness to pay premium prices for high-growth assets.

DCM got a fast and lucrative return in September for its investment in **Sling Media**, maker of the addictive SlingBox device for shifting television shows to computer and PDA screens. **EchoStar** bought the company, which raised a total of \$57 million from VCs in 2004 and 2006, for \$380 million.

Preliminary data indicates that strategic M&A returns for VC-funded companies across the board were comparatively strong in 2007. Acquisitions of venture-backed companies for which purchase prices were disclosed totaled \$20 billion in the first 11 months of the year, according to Thomson. That was up from \$17.8 billion in disclosed value M&A transactions in all of 2006.

Moreover, some of what were believed to be the largest acquisitions of 2007, such as **Microsoft's** purchase of speech technology company **Tellme Networks**, were for undisclosed sums. And going into 2008, fat cash reserves at many of the most acquisitive technology companies ought to bode well for M&A in 2007, says Doll.

## **IPO comeback**

Perhaps the most welcome development for exit-hungry VCs last year was the reinvigorated U.S. IPO market. After years of relying on M&A for the vast majority of returns, venture capitalists pocketed a sizeable portion of profits through public market offerings in 2007. True, markets weren't exactly stable, with major indexes taking a tumble—first in July, then in November—amid mounting credit crisis concerns. During those periods when stocks were performing well, however, public market investors showed a renewed appetite for growth offerings. VCs were quick to feed their cravings.

In the first 11 months of the year, 78 venture-backed companies raised \$9.67 billion through stock offerings on U.S. exchanges. That was up substantially from the prior year, when 57 VC-backed IPOs raised \$5.12 billion.

IPO activity was strong in the first half of '07, with 18 and 25 offerings from VC-funded companies in the first and second quarters, respectively. The market slowed dramatically in Q3, with just 12 new offerings, then shot up again in Q4, which is likely to see close to 30 offerings.

DCM benefited from the IPO market recovery. Two of its portfolio companies public in the latter half of the year: **Neutral Tandem**, a provider of interconnection services for telecoms, and **HireRight**, an Internet-based employment screening service.

With the IPO of wireless broadband provider **Clearwire**, DCM closed the books on its \$51 million Fund I, launched in 1996, with what Blaisdell says is “a multiple X return.” But partners will have to wait longer for carry from other funds, particularly the \$471 million DCM Fund III, raised in 2000, which like most venture vehicles of that era is still in the red.

Although it wasn't a direct investor in Clearwire, DCM generated what partners called a "significant outcome" from the IPO of the 8-year-old company. Back in 2004, Clearwire acquired broadband network builder NextNet, a DCM portfolio company, in exchange for stock.

At \$600 million, Clearwire's IPO was the biggest venture-backed U.S. technology offering of the year. The offering was also one of several large IPOs by ventures first funded during the dot-com boom. Bubble-era networking investments, including **Infinera**, a maker of digital networking components, **Starent Networks**, a mobile networking provider, and **BigBand Networks**, a developer of delivery systems for digital media, all debuted last year. The offerings ensured that VCs would at least have something to show for investments made early in the decade.

But while the IPO climate has improved, it's still too weak for Doll. "Up until early '90s, exits were about half IPOs and half M&A," he says. "Now it's more like 90% M&A. We need that number to get back more in balance."

## The road ahead

Judging by their investment pace, VCs in general are optimistic. In the first 11 months of 2007, U.S. VCs invested a robust \$39.4 billion in 4,196 companies worldwide, according to Thomson. With the pace of investment going strong into December, that number is on pace to top the 2006 total of \$42.37 billion invested in 4,920 companies.

Funding ticked up dramatically in a few sectors, including Internet marketing, data recovery and solar power. Across industries, investments in clean technology and biotech rose, while Web-based businesses continued to attract an outside portion of venture dollars.

DCM was among the more active VCs in the Internet sector, which accounted for seven out of its 24 investments last year. Its partners focused on businesses tied to online marketing, user-generated content and digital entertainment. General Partner **Peter Moran** took a board seat at **Trion World Network**, a broadband gaming and entertainment startup that raised a \$30 million round in June. And firm co-founder **David Chao** became a director at **Pandora TV**, a South Korean video site that raised \$10 million in January.

The closest DCM got to cleantech last year was a stake in a \$30 million expansion round for **BridgeLux**, a supplier of energy-saving LED chips to replace traditional bulb technologies, and a seed investment in **MicroAzure**, a lithium ion battery startup. The firm took a pass on alternative fuels, though Blaisdell maintains an interest in the sector. He worked for an alternative fuel company in the 1980s, when oil was \$12 a barrel and new energy sources were "a tough sell."

Today, conditions are much better. At least that's the consensus in the U.S. venture industry, which poured a collective \$2.21 billion into 177 cleantech companies in the first 11 months of last year—up from \$2.1 billion in 160 such companies in all of 2006.

Big rounds for a few sought-after startups accounted for much of the total. Clean coal technology developer **GreatPoint Energy**, alternative fuel provider **Imperium Renewables**, and

photovoltaic cell maker **Advent Solar**, for example, raised rounds of \$115 million, \$70 million and \$76 million, respectively. Across all industries, venture investors closed rounds in excess of \$50 million for more than 100 companies last year.

While venture confidence levels were relatively high in 2007, concerns about slowing domestic growth could impact investment activity negatively this year. “Going into 2007, there was cautious optimism,” says Blaisdell. “Going into 2008, I’d say there’s cautious pessimism,” he says. “It’s been a long time since the economy has been such a big question in the U.S.”

Of course, it would take a lot for DCM to top 2007. And while a deteriorating exit climate in 2008 would be an unwelcome development, a slowdown in new venture investments could have some upside advantages.

“Even if the exit market is bad, that probably won’t have a big impact on how many seeds we plant [in 2008],” says Blaisdell. “A down market may only indicate an ability to get into quality companies at more reasonable valuations.”

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