NEWS ANALYSIS

Renewed interest in Euro venture

In October the French Technology Fund-of-funds (FTF) was launched with €150m and a couple of months earlier Germany's Wellington Partners reached final close on its third fund, raising €150m compared with its original target of €120m. While not dramatic in themselves, the successful launch of these two new funds could signal the early sparks of renewed interest in European venture really for the first time since the dot.com crash. author name

European venture has tackled some key problems and this has clearly contributed to some successful fundraisings. But the industry is not yet out of the woods and there is a question mark over the availability of capital for sustained future fundraising.

One of the keenest European venture investors in recent years has been Swiss Re Private Equity, which has put money into nearly 20 funds. Vincenzo Narciso, vice-president, argues that on a number of levels European venture has improved in recent years: "If you look at it in terms of returns, clusters of technology, number of return entrepreneurs, the lessons learned by VCs or the capacity to build global players rather than local companies, things have got much better in Europe." He also highlights the fact that there has been an increasing number of exits via trade sales and, increasingly, IPOs: "I have a list of around 40 companies that have exited since 2001 and provided returns of five to 10 times, such as KVS, CSR, Kelkoo, Element 14, Skype and Jamba!"

On returns, Narciso says that while it is not always easy to detect trends because of research based on too-small sample sizes, European venture has performed better in IRR terms than the US in the last two years.

Jorg Uberla, a general partner at Wellington, says the successful fundraising at Wellington suggests there is definitely renewed interest in European venture but that this is largely due to the cyclical nature of the industry. "After 2000/01 people weren't interested for a few years and then a year ago the pendulum began to swing back and people moved from saying they weren't interested, period, to saying they might try some venture in the US, and then it became a little in the UK and then Germany."

But underlying this cyclical change, like Swiss Re's Narciso, he flags up structural changes benefiting the industry: "For example, when it comes to exits we're seeing increased M&A in the sector and in the last quarter M&A was as high as at the peak of the technology hype. That's because most of the larger tech companies have cleaned up their balance sheet, cut costs and become profitable, with order books looking good for the coming quarters." The crux of the matter is that those tech companies that survived the downturn have come out of it stronger, says Uberla: "We began to see these positive signs 18 months ago in our portfolio companies."

Rather than simply flagging up the European venture sector as a good investment because the pendulum is swinging back, some in the industry go a lot further in their analysis. "Looking at this sector from a risk-adjusted viewpoint and taking account of valuations and deal flow, I would argue that the European venture segment will be the most interesting opportunity globally in the next five years," says Ulrich Grabenwarter, head of VC operations at the European Investment Fund, which is one of the main investors in the French Technology Fund-of-Funds.

EURO VENTURE FUNDS RAISED 2004–NOV 2005

Fund name	Fund manager	Origin	Closing date	Total raised (€m)
Four Seasons Venture V	Four Seasons Venture	Norway	Nov-05	105
Genesis Partners III	Genesis Partners	Israel	Sep-05	150
TVM IV	Techno Venture Management	Germany	Sep-05	240
BayTech Venture Capital II	BayTech Venture Capital	Germany	Jul-05	86
Wellington Partners Technology III	Wellington Venture Partners GmbH	Germany	Jul-05	150
Accel London II	Accel Partners	UK	Jul-05	360
PVP I	Pontis Venture Partners	Austria	Jun-05	30
Herald Ventures II	Herald Ventures	UK	Jun-05	46
Martison Trigon Ventures	Martison Trigon Venture Partners	Russia	Jun-05	30
Sequoia Capital III (early stage)	Sequoia Capital	Israel	Jun-05	148
Carmel Ventures II	Carmel Ventures	Israel	May-05	160
Benchmark Israel II	Benchmark Capital	Israel	May-05	200
Delta Russia LP	Delta Capital	Russia	May-05	120
Banexi Venture Partners IV	Banexi Venture Partners	France	Apr-05	130
Index Ventures III	Index Ventures	Switzerland	Mar-05	300
Sofinnova Capital V	Sofinnova Partners	France	Feb-05	385
Ventizz Capita II	Ventizz Capital	Germany	Feb-05	60
Benchmark Europe II	Benchmark Capital	UK	Sep-04	306
Gemini Israel IV	Gemini Partners	Israel	Aug-04	170
Pitango IV	Pitango	Israel	Jul-04	300
Gamma Capital II	Gamma Capital	Austria	May-04	17
Noble Venture Finance I	Noble Venture	UK	Mar-04	66

Source Almeida Capital

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Grabenwarter acknowledges that much of the interest this year has been down to changes in the natural cycle, but he also compares favourably the attractions of European venture with other sectors such as buyouts. "In European buyouts I think we may be seeing a phenomenon of bubble behaviour and unrealistic valuations, similar to that seen in venture a few years ago," he says.

The main lesson learned by European venture capitalists, has been not simply to try and ape US models. In the US business model it has been common for VCs to invest three to four times as much as European funds in individual companies, with the aim of securing those companies' critical mass and market share. Grabenwarter says: "The problem in Europe has not been bad companies or a lack of entrepreneurs, but that fact that venture has not had the same resources as in the US and so funds have found it harder to develop companies using the US business model." Today there has been a rethink among VCs, he says, and investment strategies are more suitably aligned with the funding level, he says.

But despite the positive changes and lessons learned, some in the industry warn there is a real danger of under-investment in European venture. "We've had some successful fundraisings this year but several of those investors that have supported European venture have now spent their allocation, which means in subsequent rounds of fundraising there is less funding around," says Mounir Guen, chief executive of MVision, which has been involved in a number of venture fundraisings.

He acknowledges that in the past 18 months the venture industry has started to produce results again, with portfolios stabilising, performance improving and venture teams refocusing. But the relatively small size of European venture creates problems. For example, because venture effectively involves minority shareholdings in a single portfolio company by different VCs, it can be difficult for new VCs to get funding because their portfolio companies seem to overlap with more established VCs and therefore investors are less interested.

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Guen says: "There has been renewed interest in European venture and for good reason, but that window of opportunity is closing because the industry needs more capital in order that venture companies can grow to their potential."

Guen adds that a major injection of capital may not be forthcoming until current investments begin to demonstrate good returns, but that that may mean waiting another few years. "It's a shame because European venture has done an awful lot in the last few years to disprove those people who said there was no culture of entrepreneurship or innovation in Europe."

Those European venture fundraisings that have concluded are, anecdotal evidence suggests, supported largely by the same roll-call of LPs. At least one LP notes that each time a fund that the firm has committed to brings a final close about, it's the same names that feature alongside one another, suggesting that if European venture is starting to show sparks of life, only the few have recognised it.