NEWS ANALYSIS

Euro venture heads West

With Euro venture funds having a job getting themselves noticed by LPs in the current fund raising rounds, some think the answer is to set up an office in the US. These European VCs have either decided they are being too parochial in their investment strategies and are looking for new deal flow or they are looking to enhance the potential of their current portfolio by looking at co-investment opportunities Stateside.

Life sciences investor Abingworth has recently announced the opening of its second office in the US on the East Coast; MTI Partners is setting up an office in the US early next year; and most of the big names in Euro venture, such as 3i, Apax (although rumoured to be not so venture-focused anymore) and Atlas have established US offices or arranged a partnership with a US firm, whether it be to source new deals or as part of a business development plan for their existing portfolio companies to ensure a lucrative exit. Paul Harvey of Atlantic Bridge Ventures, which has just secured a first close on its maiden tech fund, understands the mindset of setting up in the US as a development platform for portfolio companies. He says: "The stock exchanges don't work for early growth companies in Europe. There really is no common platform across Europe for VCs to come out of their stock without damaging their stock price. People get very excited about AIM, but AIM is a one trick pony, you do an IPO and make some money, but after that there's no liquidity."

He also outlines the importance of a US base because the US VCs won't co-invest unless they see you out there and you show a commitment to the market. Harvey says: "The fact a player like MTI is going over there is an indication of where this is going. The Israeli companies have got it right; they keep their R&D in Israel and put the sales and marketing people in the States."

Venture firms starting out or considering venturing towards the US might do well to take a leaf out of Israeli VCs' book. The Israeli model of VC investment has been extremely successful in the US, most notably in terms of exits on NASDAQ. Undoubtedly the main reason these firms are successful Stateside is due to the strength of their technology.

LPs are looking for an international focus, but it is important to remember they are not looking for a fund which is spreading itself too thinly by investing in too many geographies at once. An animal such as 3i is able to do this because it has such a large infrastructure. But, on the other hand, creating a model such as 3i is in fact losing the essence of what traditional venture capital is all about.

LPs are looking for an international focus

Tycho Sneyers of LGT Capital Partners says: "Venture capital is a global play, and venture firms need to understand different markets and adapt to that environment. VCs need to think global but act local. As such, from an LP perspective, we would rather invest in teams with local strengths which may have developed a strong network of relationships with partners abroad. It is probably the best way to address the global nature of venture. Teams chasing deals in other countries will face fierce competition from established local players, unless they have a clear angle."

Alexandre Covello of LGT Capital Partners says: "For the time being, we don't see a European venture fund successfully competing for deals in the already overcrowded US space. But we do think having an office to help portfolio companies raise funds and establish relationships with US VCs for co-investment opportunities makes sense."

MTI is stressing its objective is not to be doing deals in the US, but to be working on business development opportunities for the firm's investee companies and potential exit opportunities. David Ward, senior partner at MTI Partners, says: "You can't afford to be parochial in venture. Venture is an international business, you have to be global and you have to exit globally. The primary reason for this move is to support our investee companies, which originate from the UK, and we need to support them and their growth. In three to five years time, we'll see this sort of attitude towards Asia."

Max Bleyleben of Kennet Partners, which invests both in the US and Europe from a single fund, meaning everyone on the team has the same incentives to support and develop portfolio companies on both sides of the Atlantic, says: "I don't know how much this business development office idea works. If you're not investing directly there, you're not really involved in the start-up scene and it's difficult to knock on doors and expect to be welcomed." This is why a partnership with a US VC is essential.

EURO VCS WITH US OFFICES

3i
Abingworth
Apax Partners
Atlas Venture
Earlybird
iGlobe Partners
Innovacom
Kennet Venture Partners
MTI (in the pipeline)
Partech International
Siemens Venture Capital
Sofinnova Partners
SVM STAR Ventures Management
Summit Partners
T-Venture
TVM

MTI is looking to co-locate with a major player in the US venture capital community, but not necessarily a VC firm. The partnership will also serve as a good opportunity to give the US partner a window into Europe as LPs are also beginning to see many US firms, which, in such a competitive marketplace, are being forced to look outside the US for deals. This is something Summit Partners did four years ago when it set up its London office, having been based in the US for over 17 years. Scott Collins says: "There are a significant number of US-based firms that have expanded their operations to Europe. There are fewer examples of European firms heading in the other direction: Apax, 3i and Atlas are among only a handful of examples."

Venture capital investing in life sciences is primarily a transatlantic business

Summit's landmark venture exit of Jamba! last year is a prime example. Summit invested US$40.1m for a 56% stake in September 2003 and sold it to VeriSign last June. In nine months the firm made a 3.8 times multiple and an IRR of over 300%. Being US-based in that transaction was instrumental in facilitating the acquisition.

Michael Bigham of Abingworth says: "We've always maintained the strong conviction that venture capital investing in life sciences is primarily a transatlantic business. We find that being present and active in both georgrapics provides unique insights and informs our investment strategy."

Is this what the LP wants? Mounir Guen of placement agent MVision says: "At the end of the day, what LPs are looking for is competence. Venture isn't like buyouts, it's discovering a concept, a completely different mindset and so it wouldn't matter how many offices worldwide you have; if you don't have that particular skill-set you aren't going to achieve the returns. But the US is a bigger market and if you can make it big there, it may make an impression on your LPs."

Quick flips: The fund manager's wake-up call

Recent 'quick flip' IPOs of private equity-backed companies may be widening the divide between some City fund managers and the private equity market, but on reflection, it is validation that private equity is just doing its job – and well at that. On closer inspection, such deals could precipitate a whole new way of thinking for institutional investors.

When a company is taken private by a private equity firm and then refloated a couple years later, but at a higher valuation, one would think the private equity team responsible would be applauded, rather than criticised in City columns by disgruntled fund managers. Lately, fund managers felt a need to speak out in the Sunday Times at their discomfort with such deals. And unfortunately, the recent IPO of spread betting business IG Index took the brunt of the blow. IG was taken private by buyout house CVC in 2003 for £143m and re-floated in April 2005 with a market capitalisation of £393m, with CVC retaining a 24.7% stake.

It is validation that private equity is just doing its job

The deal created some red faces among fund managers, especially those that had sold the company to CVC in the first place and were now being asked to buy shares in the company, but at a much higher valuation and were having to explain to trustees why this had happened. Despite what some fund managers might have led people to believe about the valuation of the business, it is questionable that any IPO could come to market overpriced, given the current book building methodology for pricing IPOs, says one City source. One of the main reasons these quick flip IPOs occur is to pay back the highly leveraged debt that went into the original take-private.

Many in the private equity industry, and those that advise it, believe it's time the private equity industry gets a pat on the back rather than harsh criticism for re-floating stronger companies onto global stock markets. "The institutions who sell on a take-private do so because they want to take the cash premium at the time– they do not have to accept the offer," says Charlie Geffen, head of private equity at law firm Ashurst. "If the company is then re-floated, they also have a free choice as to whether to subscribe for shares on the IPO. The market may not be perfect, but most people accept that IPOs only get away if they are priced sensibly. There may be many different reasons why value is added during ownership by a private equity firm – restructuring, consolidation, better management or even a re-rating of the sector."

In the case of IG, the management and CVC thought it was a good time to float to reduce its debt. The company wanted to be in a prime position to finance future acquisitions to build scale, which is possible due to the fragmented nature of the spread betting industry. IG's management felt comfortable that it could sell its story due to the pronounced difference in its performance since undergoing a stringent cashflow management regime under CVC's guidance. Its revenues have grown at an annual compound rate of 45% since being taken private and it has decreased its revenue volatility by changing its business model.

Prior to being taken private, IG conducted 80% of bids over the telephone, but now that figure has dropped to less than 20% with the majority of the business' activities conducted online – drastically cutting costs and boosting revenues. Under CVC's ownership IG became an intermediary rather than a bro-