Young Venture Capital Society

Volume 1, Issue 3

www.yvcs.org

Visionaries

~ The YVCS Newsletter ~

UPCOMING EVENTS

December 12, 2002

Ben Terk
Rho Ventures

Kevin Robbins
GE Equity

Will Porteous
RRE Ventures

Deal Sourcing – *An integral piece of the venture capital process and a key for young vc's striving for a position as general partner. This panel will discuss the strategies and techniques for creating great deal flow.*

EVENT DETAILS:
Location:
Credit Suisse First Boston Headquarters
11 Madison Avenue in the Clubroom on level 2b

Time:
Reception/Networking: 5:45 – 6:10PM
Speaker: 6:30 – 7:10
Q&A: 7:10 – 7:30

Price:
General Admission: $20
Business School Students: $15

***Please Register online at* www.yvcs.org**

Fighting Upstream: Getting a VC Job

An article by Mark Cicirelli

In today's market, the VC job seeker often feels like a spawning salmon fighting its way upriver. I have compiled what I hope are helpful observations from my job search since finishing my MBA this June.

Be warned that my advice is most relevant to those at the same stage of career and training. I'm very much a generalist. I received my undergrad degree in economics and government from Dartmouth, spent three years at an investment bank, one year founding and fundraising for two startups, and then received my MBA from Harvard. While I am very familiar with the private equity *process*, I am not an engineer, a biochemist, or a war-weary, metal-bending "operations guy." Those who have that sort of background will face different obstacles and opportunities in seeking a VC job.

The Environment; No Rush, Very Particular:
Pundits predict a 30% to 75% reduction in VC personnel. Venture funds are shrinking, and with them the fee income available to support salaries. Aggressive boom-years hiring, and reluctance to layoff, has resulted in excess junior staff.
Above all else, this means VC are in no rush to hire. Layoffs in banking, consulting, and VC have also resulted in an ever growing supply of highly qualified candidates. Additionally, since post-MBAs usually fill partner-track positions with an eventual claim on fund profits, VC have little incentive to hire. This environment has given them the luxury of being extraordinarily particular. Why hire someone that requires training when there is an abundance of candidates who already possess buy-side experience, a scientific degree, an MBA, were strategy consultants *and* started several successful ventures?

What to do?:
But even as the industry contracts, particular circumstances do create openings, and some people are being hired. Given the bad environment, what can improve your odds?

Proprietary "deal flow"
As in the VC business itself, creating *proprietary* deal flow is key. With so much competition, you need to uncover openings before they are widely known. Usually positions will never be advertised.
In an environment of few openings and long odds, it's a numbers game. Certain sources of leads may be more productive, but you cannot afford to neglect any. One approach is to follow industry news and anticipate hiring. Monitor electronic newsletters like *VentureWire.com* and *TheDeal.com*, and the site *Privateequitycentral.org*, and look for announcements of new fund closings, or organizational shakeups, or shifts in strategy that might result in a firm staffing up around a new initiative.

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A Word on Our Next Speakers. . .

Ben Terk

Prior to joining Rho in 1998, Ben was with Morgan Stanley & Co., for three years in their Mergers and Acquisitions Department and Venture Partners Group. He received an M.B.A. from the Wharton School of Business. Ben currently serves on the board of Alien Technology, PHT Corporation and Mahi Networks.

Will Porteous

Mr. Porteous is a Principal with RRE Ventures. He is a Director of Frictionless Commerce and TestQuest, Inc. During 1994-1995, he served in various marketing and business development roles for NetMarket, an Internet commerce pioneer now owned by Cendant Corporation. From 1996 to 1998 Mr. Porteous served as Product Manager for SupplyWorks, Inc., an application service provider for corporate purchasing. Mr. Porteous also served as a consultant to the Internet Purchasing Roundtable in the development of the Open Buying on the Internet (OBI) standard. In 1999 he was a Summer Associate at Euclid Partners.

Mr. Porteous holds an MBA from Harvard University, an MSc from the London School of Economics and Political Science, and a BA with Honors from Stanford University where he served as Captain of the Varsity Crew.

Kevin Robbins

Based in New York City, Kevin joined the Technology, Media and Telecommunications Group within GE Equity in 2000. Within this area, Kevin has focused on transactions in the software, services and media industries. Prior to joining GE Equity, Kevin worked in the Investment Banking Division at Deutsche Banc Alex. Brown where he concentrated on raising equity for a variety of Internet and technology companies. Kevin holds an AB in Economics from Dartmouth College.

~Fighting Upstream: Getting a VC Job Continued~

Better yet, if you know fund-of-fund investors or private equity lawyers, ask them who is in the market raising not-yet-announced funds

Work the network

Once you've identified a likely target, both as a way to improve your chances, and as a source of new leads, you must shamelessly work your network. You cannot hesitate to lead with your "in" and then ask for what you want. Ideally you know someone well who can personally introduce you to the firm. Personal references are easily the single best way to approach a firm. Lacking that, look for some point of commonality in background between you and the fund's management. Often this will be a university or a common prior employer. Bluntly highlight this common connection, in the subject line of the email, and make sure the *first* paragraph unambiguously communicates what you want of them (a meeting or a phone call).

Where you think a firm is hiring, but you don't have a contact, or where you have a contact, but
their firm isn't hiring – still try. Circumstances might eventually change, and your contact can point you in productive directions and make introductions.

Speaking of contacts, don't make the mistake of only networking towards the most senior people. While they may have the most sway in *their* organization, they are hardest to reach, most burned-out on networking, and probably know the least about junior hiring at other firms. Counter-intuitively, some of my best networking has been when I've networked *down* in the organization. Junior people are more generous with their time, are often more open, can give you valuable scoop about their firm, and have friends at other firms who know about the junior staffing situation.

Getting them to talk

It also takes practice to get useful information from contacts. Only after fifteen minutes of conversation, once they have had time to dwell on your situation, and once they have decided you are a quality candidate, will they begin to offer you leads and introductions. Best of all is to push for an in-person meeting, where you are most likely to have a lengthy conversation. Ask to grab a coffee or meet them at their offices. Less effective but the vast majority of your conversations will be by phone. Email is only useful to send your resume, introduce yourself, and set up a time to talk or meet. Once you're talking you need to persuade them to take ownership of your situation, and you need to differentiate yourself. Asking for "help" and "advice" on your job search strategy psychologically allies them with you, and prevents them from declining to talk because they don't have an opening at their firm. This "help/advice" phase of the conversation also gives them time to warm up to you so they are comfortable using their Rolodex for you.

Be different, have a solution

To differentiate yourself be prepared to have a well conceived point of view on where you'd be investing right now, or interesting ideas on sourcing deals, or generally some way to demonstrate that not having a VC job hasn't prevented you from acting like a VC. Make it clear that hiring you will provide a solution to whatever may be their problem. Along these lines, going to conferences will give you ideas, put you in contact with new leads, and prove your sincere interest in the business. (It's often possible to get into conferences for free or at discounts if you offer to help the organizers with event setup/breakdown

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President's Address

An Interview with Alex Wilmerding, Author of Term Sheets and Valuation

***1)** Who was your target audience for the book?*

-- This book was written with entrepreneurs in mind , to be explanatory to that audience. The focus was on trying to give a balanced view of the terms existing in term sheets, without the influence of specific market conditions. The end objective being, a knowledgeable entrepreneur who is well schooled in the basics of venture capital term sheets.

***2)** How was the book received and how is it to be utilized*

--Both entrepreneurs and finance professionals alike purchased the book. Most see it as useful resource. The book was written with the intentional perspective, that terms in term sheets are unlikely to make a cataclysmic shift, but as markets change, the weighting on any one term could change.

***3)** How does the changes in the venture capital market influence the usefulness of your book and what are some future affects*

-- The profile of term sheets 4 - 5 years ago were much more company favorable than today. The future will be influenced by changes in capital markets, how assumptions about corporate structures change and new approaches to corporate governance. Terms reflect changes in markets. The venture marketplace believes terms are becoming more rationale today, and there is an outlook that things are settling, bringing with it an easing in aggressive terms, favoring strongly entrepreneurs.

***4)** What are your future writing plans?*

-- **Deal Terms** - will be out by December 2002. It's now available on a pre-sale basis on Amazon. The book provides in-depth, first-hand perspective on the crucial terms and factors which influence financing decisions for venture investors and early and expansion stage companies. It is again a reference tool, but focuses on drilling down and providing deeper insight into key elements of term sheets and venture financing by providing real-life case studies as well as the opinions of successful entrepreneurs and legal counsel out of leading firms.

~Fighting Upstream: Getting a VC Job Continued~

Working around VC if not in it

If none of this is working, there are more creative but time-consuming ways to get noticed. VCs have mentioned that they would consider short-term consulting relationships to help them deal with troubled portfolio companies. Others have said they would welcome introductions to quality companies seeking venture investment. They are often prepared to pay for these services. Actually taking a full-time position at a portfolio company is another possibility.

Targeting the segment du jour

And if you are interested in buy-side private equity generally, there are areas that are actually thriving in this environment. Loath to lose management fees, many partnerships are shifting their investment focus rather than returning capital commitments. Mezzanine debt, biotech, distressed assets, and defense companies have all seen investment increases. If you are flexible on geography, approaching venture firms in smaller cities or suburban areas will allow you to sidestep the throngs of candidates on either coast.

Do you really want in?:

With so much turmoil, it's not always clear that any job in the industry is a good job. Numerous VC to whom I've spoken have warned that the job isn't nearly as fun as it once was, and job security no longer exists. Evaluating a job offer is complicated by the questionable viability a numerous partnerships, portfolio write-downs endangering incentive compensation, and the likely death struggles for advancement in overstaffed firms.

The good news is that for those firms that survive the shakeout, those standing will be richly rewarded during the rebound. Even if the job search is unsuccessful, the effort itself extends your network – the seeds you sow today may yield fruits in better times.

TOP LINKS

National Venture Capital Association	http://www.nvca.com
PriceWaterhouseCoopers	http://www.pwcmoneytree.com
	http://www.pwcvc.com
Silicon Valley	http://www.siliconvalley.com
Private Equity.com	http://www.privateequity.com/
VentureWire Alert	http://alert.venturewire.com
VentureWire People	http://people.venturewire.com
Boston Globe	http://digitalmass.boston.com
Red Herring	http://www.redherring.com/vc
Harvard	http://www.library.hbs.edu
Stanford	http://www.gsb.stanford.edu/ces
MIT	http://libraries.mit.edu
Kauffman Fellows Program	http://www.kauffmanfellows.org
VC Buzz	http://www.vcbuzz.com/new/vc.cgi

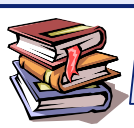
Hot Off The Press

This comprehensive work sheds light on many of the critical components of the venture industry, including how **limited partnerships** are structured and an overview of **exiting venture investments.**

The Venture Capital Cycle – by Harvard Professors Paul Gompers and Josh Lerner

Professors Gompers and Lerner highlight many of the more complex and ambiguous issues surrounding venture capital in a clear and concise manner. The work is important for those interested in learning the many intricacies to the industry. As most readers often focus on investment techniques, due diligence, deal sourcing and other, the indeed passionate should understand the inter-workings of **fund structure**, **covenants** and **deal syndication** to be truly knowledgeable about the venture capital profession.

This 342 page work covers a lot of ground, but is worth the time investment needed to completely grasp the concepts.



Resume Book

EXPOSE YOURSELF

The Young Venture Capital Society is creating a resume book for **member's only**. The YVCS is constantly approached by a variety of venture capital and private equity funds for potential candidates. If you are a venture capital job seeker this is an additional way to gain exposure to funds.

If you are a member and have not already done so, please provide the YVCS with your resume/cv.

If you are interested in having your information included in the resume book, please first register online at www.yvcs.org - registration and then provide us with your background information.

Sizing the Market

~By Todd Pietri

Venture capitalists spend a lot of time trying to estimate market size when they evaluate a new investment opportunity. The exercise is more than of academic interest. If the market is too small, the venture group will pass. If the market size is on the low end of acceptable, the valuation placed on the company will be lower than would be placed on a company, all other things being equal, with a much larger opportunity. The math behind market size analysis is straightforward. However, there is no formula or objective set of criteria that will tell you if a market is big enough for a venture capital investment. A venture capitalist's perception of a market opportunity is influenced by many subjective factors that the entrepreneur can't control or anticipate. The VC's fund size, investment strategy, past investment experience, and faith in management all play a part. A good entrepreneur looking for money will do his best to understand how these subjective factors govern a VC's analytical framework.

One should review the basics of market size analysis first. When an entrepreneur submits a plan to our firm, I am not particularly interested in top down numbers. Let's use a hypothetical example throughout this article. An early stage financial services software company, Derivatives Software, Inc.("DSI"), which automates derivatives trading, claims it has a huge market because the notional value of outstanding derivatives contracts is $X trillion. In addition, DSI tries to buttress the large market size claim by citing comparably large numbers from Gartner and Celent.

The reality is that the notional value of derivatives contracts and the commissions generated thereon are of secondary concern to me as I evaluate this market. Instead I want bottom up information. I want to know how much revenue DSI and all of its competitors combined generated last year. After all, this is the ACTUAL market size. For this example, let's say that the answer is $10 million and DSI has 20% of the market ($2 million in revenue).

Is a $10 million market big enough to merit a venture capital investment? The answer is ostensibly NO. The math simply doesn't work. If the venture investors invested $6 million at a $10 million post money valuation, then the company would have to be worth $100 million in order to generate a 10x return (assuming no further dilution). Even if the market was growing at 45% per year and DSI captured 50% of the market in 5 years or $30 million in revenue, DSI would have to sell at 3.3x revenue to meet the $100 million bogey. However VCs are loath to depend on optimistic market share projections, industry growth rates and/or high exit multiples to generate the return they seek.

Let's modify our example and examine some of the nuances to which I alluded above. Perhaps DSI tells us that only the top 10 investment banks have purchased this type of technology thus far and that these early adopters are likely to triple their number of seats. In addition, these firms are paying annual recurring fees per seat. This is when the market sizing exercise becomes more interesting and difficult, because the focus of the analysis has shifted from *actual* market size to *latent* market size. This is when we require a detailed bottom up market size analysis. We would start by asking the following: how many brokerage firms exist? How many trade derivatives? What percent of the firms that trade derivatives can cost justify an investment in DSI's technology? When we have that answer to this last question we can start to split the universe into small, medium and large prospects and test assumptions about the average numbers of seats and the average selling price for each category.

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University and Investment Banking Captains

For those interested in getting more involved in the Young Venture Capital Society, we have created the important role of the University and Investment Banking Captain.

The Role of the Captain

The captain is a critical part of the YVCS organization, and is responsible for creating and spreading awareness about upcoming events, products and services. Moreover, they are the mouthpiece or conduit for attendees to voice changes or improvements on YVCS products. They should be seen as leaders and a significant component of the management structure, as their knowledge will often be relied upon by the directors and officers of the YVCS.

Benefits to Becoming a Captain

As sign of appreciation and recognition, University and Investment Banking captains will be highlighted on the website, newsletter and will be an integral part of management's effort to formulate compelling products. In addition, prizes for top performing captains will be awarded based on their attendee and membership production. Furthermore, captains will attain complimentary event entry and membership as a result of the aforementioned attendee and member production. And finally, captains eager to become increasingly involved in the organization and management of YVCS will likely have an opportunity to take on more responsibility.

Who Should Apply

In the eyes of management, the captain is an extremely important role. A role for a driven, intelligent and passionate individual at either a university or investment bank.

Next Steps

Should you be interested in pursuing this opportunity, please contact us at www.yvcs.org.

1) Let us know what you think about the events, the organization etc

2) What do you think of "Visionaries?"

3) Get involved!

info@yvcs.org

Sizing the Market by Todd Pietri

Lastly we have to make some assumptions about how fast the industry will adopt. The best way to make rational assumptions is to look at what DSI has sold to date, talk to their customers and prospects and ask industry experts.

Let's assume that after our due diligence we can accept the following: the market can grow to $75 million in 3 years; and DSI can grow from $2 million to $15 million (20% share) with 25% EBITDA margins over that time frame. Is the market big enough now?

The answer depends on which firms are investing, how much capital the company needs to meet their projections, the valuation the entrepreneurs are willing to accept, the quality of the management team and the downside risk. If the company needed $1.5 million to meet their projections and was asking for a $2.5 million pre money valuation, the chances are pretty good that a small fund or group of small funds would be interested in the investment. This is because if you exit the investment at 2.5x sales or 10x EBITDA (the recurring revenue model is quite valuable), you would make almost 10x your investment.

The big funds wouldn't want anything to do with the deal. When a firm has $150 million or more to invest, it is not feasible to put out money in small blocks (significantly less than less than 5% of committed capital). Even some of the smaller funds would look at a $15 million company in three years and yawn. This is because many VCs believe, based on past experience, that if a company has under $20 million in sales, it is not an IPO candidate and it won't be able to attract the attention of a significant acquirer, which will depress the exit multiple to 1x sales. Even worse, you might not be able to sell the company at all if it is too small.

The final decision to invest or not in a deal like this may depend on downside risk and management talent. If the company is unlikely to run out of money and go out of business and you know you could sell it to a player in the space for something, your downside is protected. Furthermore, if the management team has proven in the past they can develop add-on products and have a credible plan to take advantage of identifiable opportunities in adjacent markets, you might reason that the company will grow beyond its base business (these opportunities will be heavily discounted though). As you can see, market size analysis will always be as much art as science.

U.S. VENTURE INVESTMENT AT LOWEST LEVEL IN FOUR YEARS

Amid general downward trend, select software categories show hopeful signs, according to

Ernst & Young/VentureOne Venture Capital Survey

San Francisco and New York, October 25, 2002—With $3.9 billion invested in 464 financing rounds, investment in the third quarter of 2002 was at its lowest level in four years, according to Ernst & Young and VentureOne's joint U.S. venture capital survey. The number of venture capital transactions has fallen to levels commensurate with 1996-1997, although at $6.7 million, the median amount of capital invested in each deal is still higher. Compared to last year at this time, investment is at roughly half the volume and deal flow has declined by a third.

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Venture Capital Magazines~

As we are all inundated with news and data, it is easy to miss important articles and interesting columns. Here at the YVCS, we have attempted to help out with highlighting some of the recent articles outstanding.

Venture Capital Journal, is an extremely informative magazine that has thought provoking interviews and lead stories. Unfortunately, their high rates remain out of reach for would-be readers.

VentureWire is one. They have a professional (more services, more content, more expensive), aspect but they simultaneously offer a free daily email.

VentureReporter (F.K.A Silicon Alley Reporter) is a perceptive magazine that remains observant of key trends and takeaways of the current venture community. It does a high quality job of combining funding, capital raising, interviews, and pressing topics into one publication. In addition, this journal is more readily available and affordable with its $100 yearly subscription rate.

Beth Healy, **Boston Globe** puts together a weekly piece centering on venture capital in the nation's number two VC hub, Massachusetts. She often has interesting points regarding the venture community as a whole and not only specific to the northeast. In addition, her pieces are succinct and concise.

Coming Soon

Coming soon to the Young Venture Capital Society

~Networking on the net - email lists for members to further establish relationships and connections. 'In addition, this service should be a medium for cultivating questions and answers between members.

~VC Experts Relationship - This relationship will allow members and attendees to purchase VC experts' products for a discounted amount. The VC Experts, website, www.vcexperts.com provides a wealth of venture capital knowledge through their venture capital encyclopedia, library and other resources.

~Additional Manuals and Resource Directories - the Young Venture Capital Society, is in the process of producing a number of resource manuals and directories for venture capital enthusiasts.

~What products and services would you like to see from the Young Venture Capital Society. . .
LET US KNOW, www.yvcs.org

While not minimizing the importance of a down quarter, John Gabbert, Vice President of Worldwide Research at VentureOne, points out that transaction size is a significant factor: "We're seeing a regression toward the median in deal sizes, so there are no longer exceedingly large financing rounds to beef up the overall amount invested. This reflects the impact of the public markets: investors are less willing to put large sums of cash on the line with no liquidity in site, and companies are in sustained growth mode—raising enough to continue operations, but not gearing up for an immediate IPO or acquisition."
Indeed, liquidity options were scarce in the third quarter, with just one company—HealtheTech (Nasdaq: HETC)—completing an IPO, and M&A transaction volume falling 35%. Those companies that completed an acquisition were most likely to be in the software segment, as was true for financing rounds in general. Software companies accounted for 35% of both the acquisitions and the venture capital deals in 3Q02, and in a quarter when investment was almost uniformly down, software investment increased 28%, to $1.2 billion. Crucial to this growth were business applications software and connectivity and communications tools companies, which saw deal volume increase 14% and 44%, respectively.

Bryan Pearce, Venture Capital Advisory Group Leader at Ernst & Young, commented: "The growth in software investment can be attributed to those sectors that are the current focus of government and corporate spending. These include security—important to both the Federal Government and to the enterprise market—as well as data center management and enterprise application integrations, which are among the few areas where major corporations are increasing IT spending."

Regarding the quarter's diminished investment results, Mr. Pearce was circumspect: "This is partly a reflection of a 'flight to capital efficiency' on the part of VC firms. Software is one area where a relatively small amount of investment capital is required to form a company and get a product to market, which can then be sold within a reasonably short period of time. Mr. Pearce further noted that from a venture-backed company perspective, "When you see the time between financing rounds increase from a median of 9.5 months in 2000 to 17 months in 2002, you know executives are finding ways to stretch their budgets. This is either because they're loathe to raise large sums at low valuations, or because they've identified partnering opportunities and alternative cash sources that will allow them to maintain operations until the economy picks up."
Venture capitalists continued to focus on existing portfolio companies, with only a third of the deal flow falling into the seed and first round category. New company formation is an indicator of future financing activity, and software led the pack in this area as well: Of the quarter's 143 seed and first round deals, 38% were done by software companies. Biopharmaceuticals companies, which had completed a large percentage of these early rounds during the first half of the year, were less active in the third quarter. Healthcare investment overall was approximately half that seen last quarter, with sharp declines in all segments but healthcare services.

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The investment figures included in this release are based on aggregate findings of VentureOne's proprietary US research. This data was collected by surveying professional venture capital firms, through in-depth interviews with company CEOs and CFOs, and from secondary sources. These venture capital statistics are for equity investments into early-stage, innovative companies and do not include companies receiving funding solely from corporate, individual, and/or government investors.

VC 2003 NYC…Exploring the Business of Venture Capital Investments

January 23, 2003 New York, NY
Register Now

VC 2003 NYC is a one-day, invitation-only, educational seminar designed exclusively for private equity investors. VC 2003 NYC will address the business of venture capital as it relates to limited partner relations, trends in VC compensation, fundraising in today's market, exploring non-traditional liquidity opportunities and many other issues that are changing the landscape of venture investing.

Who Should Attend?

Managing Directors, Managing Partners, Partners, Principals, Associates and Analysts Within Venture Capital Funds, Private Equity Firms, LBO Funds and Angel Organizations.

VC 2003 NYC will also include a special afternoon pass for MBAs from leading universities who plan to have careers in private equity. More Information

Registration and Fees

- **Early Bird Registration**
(now through November 30, 2002)* $595.00
- **Standard Registration**
(December 1, 2002-January 22nd) $695.00
- **Onsite Registration**
$735.00
- **Special Afternoon Only Pass****
$275.00

*Special group rates available. For more information, email us or call 703.609.6610.

**Access to afternoon program and cocktail party only

For more information and registration, click here