



Visionaries

~ The YVCS Newsletter ~

UPCOMING EVENTS

NEW YORK: PR Boot Camp(WORKSHOP)

Event Participants

- Susan Lindner, CEO, Lotus PR
- Chris Capra, Director, Lotus PR
- Kimberly Meyers, Director of Marketing, XMPie

Date: April 19, 2006

Description:

- This exclusive workshop will demonstrate the power of public relations in driving sales and returns for startups. The attendees will glean insight into where and why VCs and startups need to employ PR companies and the do's and don'ts of utilizing this type of service.

Register & More Info: www.yvcs.org

LONDON: Valuation – An Analysis of VC/PE Valuation Techniques

Event Participants

- Peter Rowell, Chairman, Regent Associates
- Professor Eli Talmor, London Business School
- George Powlick, Doughty Hanson TechVentures
- John O'Donohue, Motorola Ventures Europe
- Myles Davis, Panmure Gordon & Co.

Date: May 12, 2006

Description:

The Panel will help educate attendees on the following:

- o The variations in valuation across different industries, and geographies
- o AIM market versus private money valuations,
- o And understand how to value a company, etc

Register & More Info: www.yvcs.org

An LP's Perspective The Small & Emerging Manager Opportunity

By: C. Priestley (Credit Suisse Fund of Funds)

Fundraising across the private equity asset class has been especially robust in the last few years, leading to a supply and demand dynamic heavily in favor of GPs. Given the increased LP appetite for private equity (and thus the amount of capital targeting the space), blue chip private equity firms can be very selective with respect to whom they bring on as investors. The excess capital being turned away, either for capacity reasons or FOIA issues, has trickled down to the small and emerging manager ("SEM") market, which has recently experienced significant investor demand.

Drivers of the Opportunity

Driving the focus on this market segment is an increasingly competitive environment among larger, more established funds. As the market for larger managers and transactions becomes increasingly efficient, the return profile becomes potentially less attractive. For instance, smaller capitalized funds have outperformed larger funds over the past 10, 15 and 20-year time horizons. Such performance is likely to continue due to attractive market fundamentals at the smaller end of the private equity market, which is more fragmented, offering favorable entry multiples, greater opportunity for multiple expansion and consolidation as well as more exit opportunities.

For example, buyout purchase price multiples have increased as a whole over the last five years, but have remained relatively constant at the lower end of the middle market. Entry multiples for companies \$250 million or less have moved from 5.8x to 6.6x during the 2001-2004 time frame. Corresponding entry multiples for companies \$500 million or greater range from 6.3x to 7.4x. In addition, annual M&A exit volume has been consistently robust at the lower end of the middle market, outpacing the average volume of larger targets by over \$30 million from 2001-2004.

This combination of factors has led many seasoned investment professionals to refocus on their original successes, venturing out on their own or in smaller groups to raise smaller funds.

Investment Thesis

From an LP perspective, the SEM market will remain a compelling investment opportunity for a number of reasons. With respect to diversification, emerging funds give investors an ability to more clearly target a given sector, strategy or geography.

[AnLP's Perspective Continued on the Next Page.]

Spotlight on Startups

Bay Ridge Partners

Business Description

Bay Ridge Partners invests in intellectual property, specifically consumer electronics patents. The company is structured as a “search fund” (also known as a “pledge fund”) to buy patents that have an expected return of 3x-to-10x within a 2-4 year investment period. The patent investment market is inefficient and opaque; i.e. valuable patents are often under-priced by sellers. We have a proven business model to buy patents, “turn-around” the patents, and sell the patents to Fortune 500 technology companies.

Product Offering

Our company has a unique value proposition to 2 separate constituencies: 1) patent sellers, and 2) patent buyers. To patent sellers, Bay Ridge Partners offers a low-risk, fast-tracked liquidity alternative for monetizing non-core patent assets. To patent buyers, Bay Ridge Partners offers a fully-developed strategic patent portfolio (i.e. buy vs. build).

Market Size

The patent licensing market grew from \$15B in 1990 to \$110 in 1999 (“Ideas to Assets” published by John Wiley & Sons 2002). Salomon Smith Barney equity analysts estimate IBM alone generates \$1B to \$2B in annual patent licensing revenue. Ocean Tomo’s upcoming April 2006 patent auction highlights the growing liquidity in the market.

Clients

The sourcing strategy to identify patent sellers includes generating proprietary industry research and established relationships with third party patent brokers. In addition, we are actively maintaining “interest lists” from patent buyers, including major technology companies.

Competitors

At least 3 major institutional investors have created patent investment funds: Intellectual Ventures (\$350M) (<http://www.intellectualventures.com/>), Ocean Tomo (\$200M) (<http://www.oceantomo.com/>), and Altitude Capital Partners (\$200M) (<http://www.altitudecapital.com/>)

[*Spotlight on Startups Continued on the Next Page.*]

For instance, SEM funds increasingly focus on emerging geographies (e.g., the Southwest, Pacific Northwest) and sectors (e.g., energy, nanotechnology) virtually ignored by more established funds.

Investing in SEMs also provides an opportunity to develop a relationship with a manager early, which helps to gain a meaningful allocation to the current and possible future funds. This has become an increasingly important issue, particularly in the venture capital space, as LPs seek larger bite sizes in an effort to put more capital to work.

In addition, SEMs often have a better alignment of interests with LPs given that they have more to gain from the success of their initial funds. For example, management fees typically cover expenses, as opposed to being utilized as a profit center. SEMs are also more willing to accommodate financial and structuring arrangements than their more established brethren.

Evaluation of a SEM

Due diligence on a SEM often requires a savvier LP perspective to evaluate issues more commonly associated with emerging groups than with more established managers. Some topics for consideration include the following:

- Limited track record – SEMs may have limited private equity investment experience in terms of capital invested, capital realized and maturity of portfolio companies. An institutional investor needs the resources and capabilities to independently analyze an SEM’s prior performance including the professionals’ operating experience, value generation through board participation and roles in deal sourcing, execution and exit.
- Deal attribution – An SEMs actual contribution to various investment activities may often be difficult to determine. An institutional investor should conduct an extensive independent reference calling effort to confirm the manager’s involvement in investment activities and validate each professional’s ability to operate outside of an established private equity franchise.
- Lack of institutional investment experience – While SEMs are generally well-versed with the scientific, technological and operational aspects of companies, they may not have experience managing third party institutional capital. Consequently, they may have a limited understanding of the LP community, as well as legal terms and conditions. An institutional investor should utilize its expertise to ensure that the partnership is managed to institutional quality standards.
- Limited experience working as a team – The investment professionals of SEMs may not have had substantial experience making investments as a collective group. An institutional investor must analyze the level of collaboration, common prior experience (e.g., co-investments, industry/educational organizations) and commitment of the principals.

Despite the demand for SEM funds, the fundraising hurdle for new firms continues to be high as institutional LPs require that emerging managers come with a pedigree and a historical track record of success within their stated strategy. Expect the SEM space to continue to be a compelling investment option for LPs going forward.

Sources:

National Venture Capital Association, Standard & Poor’s M&A Statistics, SDC Platinum, a Thomson Financial company, Thomson Venture Economics, a Thomson Financial company.

Copyright © 2006 YVCS

Management

The founder has 5 years of unique transaction experience and track record in patent commercialization with two pioneering firms: IPVALUE Management and Walker Digital Corporation. In addition, he brings experiences from a technology-focused investment banking boutique and a “Big 4” technology consulting firm. Technology and legal diligence will be outsourced to a network of expert third party contractors.

Financial overview

Working capital of \$1M is divided between three key operational processes: 1) Sourcing, 2) Development, and 3) Sales. The working capital will finance 2-4 years of operation. In addition to working capital, the company will deploy investment capital of \$5M. Management equity participation will be contingent on exceeding “hurdle” rates of return for investors.

Capital Raise

The total search fund capitalization is targeted at \$6M, composed of working capital (\$1M) and investment capital (\$5M). The current seed round is targeted at \$500K, to finance the company’s operations for 1-2 years. The operational milestone for seed capital is completion of sourcing and performing diligence on an attractive investment opportunity.

Advisory Board

The Bay Ridge Partners Advisory Board is made up of 9 people from diverse backgrounds: 3 investment professionals, patent software entrepreneur, technology R&D veteran, Fortune 500 patent strategy professional, NYU finance professor, strategy consultant, and patent attorney.

Contact

To contact Bay Ridge Partners to learn more about their capital raising endeavors, please email: info@yvc.org.



Biotech Investing Beyond the Hype



By Deverraux Jones

The emergence and subsequent adoption or rejection of new technologies is a process investors must remain keenly aware of. Every VC investor at some point faces tough timing questions such as: When is it “too early” to invest? Is the technology over-hyped and overpriced? Has this technology reached or extended beyond its maturity? Answering these questions, and more importantly, answering them with some degree of accuracy, requires an intimate knowledge of the technology’s industry, a clear identification of the key market drivers, and sometimes...just a little bit of luck.

The biotechnology industry has had its share of technologies that were over-hyped and under-delivered. Over the past few years there has been unprecedented anticipation followed by disappointment in market bubbles, in industries such as gene therapy and stem cells.

As these technologies emerged, the industry and popular media have touted the impact that such technologies would have on the drug development cycle and their potential to rid society of many diseases. Words such as “paradigm shift” and “holy grail” were used liberally, as stock prices soared and expectations reached stratospheric heights. Unfortunately, the promise of these technologies was never fully realized and the expectations, along with much of the money chasing them, came back to reality.

Gene Therapy

In the case of gene therapy, the proposition was a compelling one. Many diseases such as cancer, immunodeficiencies, cystic fibrosis, and sickle cell anemia are caused by mutations of certain genes that normally create important biological proteins. Gene therapy proposes delivering functional copies of these “defective” genes to the appropriate cells in the body, thus creating the appropriate proteins and hopefully curing the symptoms of the disease.

This approach, however, has faced several setbacks to potential commercialization of the technology. For example, despite years of research, gene therapy has failed to deliver any practical advances in treating cystic fibrosis. Due to problems in delivering the “corrected” gene and “expressing,” or copying, enough of the gene to cure the disease, research on this disease has stagnated.

In other cases, there has been tragic loss of life in experimental treatments that has undermined the regulatory and financial environment necessary to incubate companies in this field. In 1999, a teenager under treatment of the University of Pennsylvania died of a massive immune reaction to the gene treatment for a rare metabolic disorder. Less than five years later, two French children undergoing successful treatment for an immune disorder often known as “bubble boy disease” (patients must live sheltered in large plastic bubbles to avoid infection), developed leukemia as a byproduct of the treatment. Because of these cases and the uncertainty surrounding the efficacy and safety of gene therapy, companies have had a difficult time raising money, despite early enthusiasm about gene therapy’s promise. [*AnLP’s Perspective Continued on the Next Page.*]

FundWatch

MILESTONE VENTURE PARTNERS

Fund Description

Milestone is a traditional early stage, venture capital partnership started in 1999, with a focus on technology enhanced services. Milestone actively invests in the Greater New York area (NY, NJ, CT, PA). Companies that fit the Milestone criteria are capital efficient businesses that require less than \$10 million dollars of paid-in-capital in order to generate 5-10x returns.

Fund History and Assets Under Management

Milestone Venture Partners I was started as a personal investing vehicle for Mr. Goodman. Mr. Goodman and Mr. Pietri launched Milestone Venture Partners II in 2001 with \$13 million dollars under management and has since fully invested the capital in 13 portfolio companies. Currently, MVP is capital raising for Milestone Venture Partners III with an expected fund size of \$75 million. The first close of \$30 million is expected April 14th. The limited partners of Milestone Venture Partners II and III include high net worth individuals and family offices, although they expect to add institutional investors in subsequent closes of MVP III.

Sector Focus

MVP is focused on technology-enhanced services. The fund prefers applied technology investing as opposed to investing in core technology (semiconductor chips, networking equipment etc). Some of the specific areas of interest include software-as-a-service, content with web services, and business process outsourcing. More specifically, the fund typically evaluates opportunities in three verticals: the financial services IT, healthcare IT, and media and marketing services sectors.

Stage Focus

Milestone is an early stage investor in revenue generating companies with modest burn rates. MVP is the lead investor in about 75% of their investments.

Investment Size

Milestone invests between \$250K and \$2mm over the life of an investment.

[FundWatch Continued on the Next Page.]

Stem Cell Therapy

The use of stem cell therapy as a novel mechanism for treating disease has also gone through cycles of inflationary expectations and reactionary disappointments. In the 1990's dozens of stem cell companies emerged in the public markets based on the belief that cell-based therapies were a "safe bet."

For example, PPL Therapeutics approached a \$1 billion market cap in 1997 after gaining international exposure for cloning Dolly the sheep. By 2003, however, the company shut down because it failed to commercialize its scientific advances.

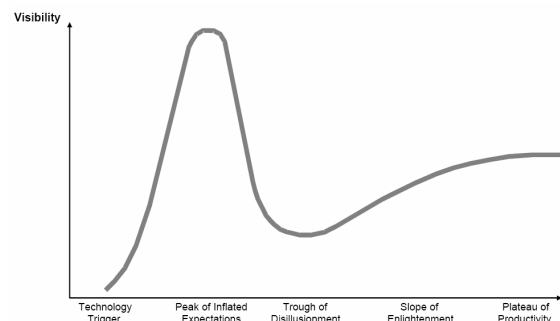
Today the market for stem cell companies seeking financing remains challenging. Because of scientific and political roadblocks to the development of this technology, venture capitalists have remained cautious in backing stem cell based companies. The recent disclosure of South Korean scientist Hwang Woo-Suk's fabricated stem cell research (omit reference to where it's published, or else spell out the name of the publication? in the Wall Street Journal / or "a major medical journal" or wherever it was published...) reflects the difficulty researchers and companies have faced in progressing scientifically in this field.

Meanwhile, the ethical implications of embryonic stem cell research have triggered a political firestorm in the United States that has cooled investor enthusiasm for related companies. In an interview with Red Herring magazine, William Caldwell, CEO of the human embryonic stem cell company Advanced Cell Technology noted that "venture capitalists are willing to take financial risks, market risks, management risks, but the one thing they are not happy to do is to take political risks."

Seeing Beyond the Hype

Although fields such as gene therapy and stem cell technology may ultimately become scientifically validated and achieve commercial success in the future, several companies have failed and many investors have lost money because of mistimed financing along the technology adoption cycle. After technologies emerge, they often go through a phase of inflated expectations followed by disillusionment when the technology fails to deliver on unrealistic projections. As businesses begin to understand the benefits and practical applicability of the technology, they often eventually reach a plateau of productivity.

This "Hype Cycle" illustrated below, depicts many technologies including potentially revolutionary advances in the biotech industry. To remain successful, investors must be able to separate reality from hype and select optimal entry points with the right companies that can survive this cycle. Ways of separating the grounded from the hyped companies include ... (watching for companies that fail to commercialize their technology? and ...) Without weeding through the hype, VCs run a serious risk of paying inflated prices for inflated expectations.



Copyright © 2006 YVCS

MVP II and MVP III Portfolio Companies

Skillsurvey (www.skillsurvey.com), Gene IT (www.gene-it.com), Decidia Decision Systems (www.decidia.com), RichFX (www.richfx.com), Ecosystems Design (www.eco-online.com), CareGain (www.caregain.com), Navtrak (www.navtrak.net), Derivatives Portfolio Management (www.dpmlc.com), ExpertPlan (www.expertplan.com), Knovel (www.knovel.com), Medidata Solutions (www.medidasolutions.com), Octagon Research Solutions (www.octagonresearch.com)

Management

Ed Goodman , Co-Founder and GP,

- Patricof & Co.
- Hambros Bank
- Yale and Columbia

Todd Pietri, Co-Founder and GP

- CompuSystems
- Callier Interests
- Legacy Securities Corp
- Duke and Georgia State University

Richard Dumler, GP

- Allstate
- Bessemer Venture Partners
- Lambda Funds
- Georgetown and U. Michigan

Contact Information

Richard J. Dumler
rjd@milestonevp.com

Edwin A. Goodman
eag@milestonevp.com

Todd T. Pietri
ttp@milestonevp.com

Milestone Venture Partners
551 Madison Avenue
7th Floor
New York, NY 10022
Voice: 212-223-7400
Fax: 212-223-0315

Copyright © 2006 YVCS



Deep Pockets:



Institutional Investor Peer Effect

By: James Bachman

Ivory tower investors wear two very important hats during the fund raising process. The first and most obvious of which is that they allocate funds to qualified managers. The second and less obvious is that their actions signal the quality of the venture capitalist group to other institutional investors. This effect can be so strong that some investors are unwilling to reveal their allocation decision to other investors because it could possibly lead to one of two extreme outcomes. If the ivory tower investor reveals that they have made an allocation, it could lead to an oversubscribed fund. In the opposing case, it may literally stifle the fund raising process for the venture capital group.

The aforementioned scenario depicts what is commonly known as the "peer effect." To industry outsiders this may seem like a strange phenomenon, but like most behavior it does reflect economic rationale. The rationale for such behavior rests on the fact that most of the ivory tower investors are subject to at least one of the following principles:

- **Fiduciary Duty** - A fiduciary duty is the highest standard of care imposed at either equity or law. A fiduciary is expected to be extremely loyal to the person they owe the duty (the "principal"): they must not put their personal interests before the duty, and must not profit from their position as a fiduciary, unless the principal consents. The fiduciary relationship is highlighted by good faith, loyalty and trust. (Source: Wikipedia.org)
- **Prudent Man Rule** - Under the Prudent Man Rule, when the governing trust instrument or state law is silent concerning the types of investments permitted, the fiduciary is required to invest trust assets as a "prudent man" would invest his own property, keeping in mind: the needs of the beneficiaries, the need to preserve the estate (or corpus of the trust) and the amount and regularity of income. The Prudent Man Rule requires that each investment be judged on its own merits. (Source: Wikipedia.org)
- **Business Judgment Rule** - A rule of law that provides corporate immunity to directors of corporations protecting them from liability for the consequences of informed decisions made in good faith. (Source: Dictionary.com)

Conformance with these principles suggest that the investment decision process is diligent and logical.

An additional rationale for the peer effect is that investors gain an added level of comfort if a well known investor has already placed money with the venture capital group. This is essentially the limited partner's synthetic equivalent of syndicating a deal.

[Deep Pockets Continued on the Next Page.]

GET INVOLVED

YVCS currently has **1,453 Members** located throughout the world. 2006 stands to be a tremendous year for the organization, with launches of regional chapters, new content and tools.

As we continue to grow and expand we are looking **for new additions to the team**

- Vice President, Sponsorship and Contributions
- Vice President, Marketing and Awareness

Additionally, as always, we are always looking for new contributors to the newsletter. If you have interesting ideas on venture capital, entrepreneurship, technology, capital raising, limited partners, the alternative asset class (distressed debt, hedge funds, buyout etc) we would like to know and share those ideas with the membership base. Contact us.

Contact us at info@yvcs.org for more info

YVCS SPONSORS INCLUDE:

 RRE Ventures







The implication of the above discussion is that fund raising may be subject to a momentum component. If that is the case, then there may be a tipping point where fund raising will be substantially easier if ivory tower investors have chosen to allocate to the prospective fund. This further suggests that it is important to build relationships with these groups in order to increase your visibility. Relationship building with these groups can take a number of years. As a final note, these groups are always being approached from groups trying to raise their next fund. In order to differentiate yourself, you may consider visiting these groups when you are not actively seeking assets because it is a great way to build a relationship that does not solely revolve around asking for money.

Copyright © 2006 YVCS

TechWatch:



Podcasts: Pay to Play?

By: Eric Olson

I originally began thinking of this article when I read the announcement that Ricky Gervais had “gone paid”. This was very upsetting news to me as I saw Ricky’s podcast as one that could really bring podcasting to the mainstream. Instead, he chose to go with the pay to play model which places a wall around his content, limits his audience and, therefore, limits the relevancy of his content (or “his share of voice”).

I know what some of you are thinking and, no, this is not another rant about how podcasts should not be monetized. I am a podcaster (www.ventureweek.com) and I happen to think that podcasters should be able to make money on the content they work so hard to produce. I just wonder if charging a subscription is the way to go. Scratch that, I don’t think that subscriptions are the way to go. In my opinion, giving away ad supported content is the best method and there are two main reasons for this.

1. Share of voice is preserved and allowed to flourish.
2. People don’t mind ads and, in fact, actually prefer them to paying for content.

The first reason is a no brainer. Since anyone can download your show at any time your show will undoubtedly grow (if you are producing good content of course). Keeping barriers to your content at a minimum makes your content very valuable since it can be easily linked and discussed. For example, we always talked about the latest Ricky Gervais podcast at work every Monday and now none of us listen. Ricky has effectively been erased from our usual office conversation.

The second reason is a bit harder to prove but I, as well as many others, have always felt it was the case because it is how TV and Radio work and we have seen the success there. With that said, Ad Age put out an article recently discussing a study on people and their reaction to ads vs. pay to play for iTunes TV shows. The article shows that ad supported content is preferred to paid (I am assuming podcasts are in the same boat as the iTunes TV shows). Fred Wilson of Union Square Ventures blogged about the Ad Age article and I think he hits the nail right on the head with this comment:

[Podcast Pay to Play Continued on the Next Page.]

Energy - A Brief Discussion

By Chris Reese

Energy has emerged as one of the defining problems facing humanity in the early 21st century. Drastic increases in the prices of all petroleum products in the past few years have caused both individuals and corporations to allocate a larger percentage of their expenditures to energy. The world economy has shown resilience despite these increased costs. However, higher prices only mask the true problem: world oil production based on traditional methods will inevitably peak and then trickle away. Whenever it does happen, dwindling oil supply from traditional sources will cause further price increases and has the potential to cause geopolitical strife. Alternative methods of producing petroleum reserves, such as from shale or oil sands, are currently too costly but given drastically higher prices they may become viable. However, with costs that high the development of alternative sources of energy based upon environmentally friendly technologies will become competitive. Currently these technologies are still based upon costly and underdeveloped technologies. Despite current obstacles, these technologies offer such promise that venture capitalists have taken notice and are investing in their development. The two most promising avenues for investment are technologies to conserve energy through more efficient use and technologies that allow the use of alternative fuels.

The passing of the Energy Policy Act of 2005 (EPA) will increase government support for new energy technologies through a mix of tax subsidies, R&D grants and favorable legislation. Critics of alternative energy sources are quick to note that many of these forms are not economically viable without subsidies; however a quick look at the EPA will show a large number of subsidies going to the oil industry which speaks to its viability as an ongoing energy system. For alternative energies to thrive they will require a similar level of support to what the oil industry has enjoyed since its infancy. This support will come not only from the government but also from corporations including those oil companies that alternative energies hope to supplant.

[Read the Full Article at www.yvcs.org]

“Sure a paid model will work. But it's a niche business. The mass market wants free and ad supported content, the way they get it on TV today.”

It is a niche business. I don't have any numbers on this but I am sure that Gervais' audience has dropped considerably since he went paid. Now, instead of a widely loved and listened to show that could rival radio he has a niche podcast that a handful (possibly still a large handful) of people pay to listen to. I suppose the same could be said for Stern going to Sirius. His audience isn't nearly the size it used to be but he made (and makes) a ton of money so he probably doesn't care. I personally would have loved to see him (Gervais) go the completely ad supported podcast route as it would have definitely legitimized the space quickly while still making him a ton of money and preserving his share of voice.

Back to the Ad Age piece. Here is a snippet of what the article gave for stats so you can see for yourself. It is the same snippet Fred posted on his blog and I think it tells the story well.

“The survey found that 54% of respondents would be more likely to purchase an iPod if TV programs could be downloaded free of charge in exchange for watching a 30-second advertisement.

Among those actually planning to purchase a video iPod, 72% said they would be more likely to download a TV program in exchange for watching an ad. The Magid study surveyed 798 iPod owners between the ages of 12 and 55.

‘It appears that the option to download content of choice for free will dramatically increase interest in purchasing a video iPod, thus potentially increasing video iPod sales and penetration,’ the study concluded.”

Mass media should be free and ad supported. That model works and people are used to it. Even XM Radio is beginning to go partly ad supported. Media wants to be free and it is going to take a lot of work to suppress that urge (if it can even be suppressed). Rather than fighting it we should just embrace it and create the revenue by selling ads. There is no doubt in my mind that there is at least a similar amount of money to be made with ads as opposed to subscriptions (if not more) and, as a bonus, you keep your share of voice by making your content open to anyone who wants to listen.

Caveat: Some podcast subscription models can work especially if there is a value add involved. For example, if the Wall Street Journal put out a podcast version of their daily edition where I could signal the sections I wanted to read and have them sent to me automatically in a nicely packaged personal podcast everyday I would pay for that. It would be a huge time saver and would allow me to listen to the news while standing on the “L” (it's hard to read a paper like that). This is a situation where I am now going without the WSJ news because of logistics so the proposed service really eliminates a pain of mine.

Copyright © 2006 YVCS