FEATURE **SECONDARIES**

LIQUID VENTURE

The emerging venture secondaries market is gaining traction as VCs look to offload decade old dot.com investments lingering in their portfolios and free up capital.

Many of the technology investments made in haste by venture capitalists at the peak of the dot.com bubble are now being repented at leisure. Those investee companies that have not gone bust or been sold off in IPOs – roughly one-third of the total – are still clogging up investor portfolios even a decade after they were acquired.

This is clearly something of an embarrassment to some of the general partners concerned, especially since many of their limited partners would now rather deploy their capital in more productive ways. Apax Partners and 3i, for example, have both changed tack since the 1990s in order to focus on larger buyout type deals. Yet both still have scores of underperforming technology and early stage investments on their books, which they are becoming increasingly keen to offload.

Luckily a new breed of specialist venture capital secondaries player has emerged in recent years to help take up the slack – bringing much needed liquidity to an otherwise sclerotic part of the market. Secondaries houses that are already playing an active part in this market segment include Munich-based Cipio Partners, San Francisco-based Saints Capital, Industry Ventures, Lake Street Capital, London-based Pantheon Ventures and Paul Capital. Their ranks have also been swelled by several UK-based start-ups including Azini Capital, Shackleton Ventures and Tempo Capital Partners.

Michael Bennett, founder and partner in Azini Capital, says: "There are masses of technology companies out there which have been through a number of venture capital funding rounds but failed to reach the stars. They may be turning over £5m to £10m and be at or about to reach break even. However some of their shareholders might be out of time, out of money, have changed their strategy or be in need of liquidity."

Based in Kingston-upon-Thames, Azini Capital last September completed its first £30m fund raising with backing from two larger secondaries players – Greenpark Capital and Lexington Partners. Bennett says it is looking to "liberate value in companies that require additional time and fresh capital in order to realise maximum value."

He explains that Azini differs from players like Shackleton in that it prefers to invest on a company-by-company basis rather than taking on patchier job lots of assets. He believes this enables it to focus on quality assets that have strong future prospects and for which market prices are more justified.

In its first deal Azini Capital last September bought a number of shareholdings in growth-stage technology firms from the property company CLS Holdings, as well as a part share of a fund managed by Pond Ventures, the Silicon Valley-based venture capital investor. The CLS deal brought stakes in three Cambridge-based technology companies – Amino Technologies, an Aim-listed maker of set-top boxes, Antenova which makes antennae, and Keronite which makes ultra-resilient coatings. Meanwhile the Pond Ventures fund owns stakes in Picochip, a Bath-based chip designer and Transitive, a software company that has offices in Manchester and California.

Bennett says: "A lot of money was invested in venture capital in 1998 and 1999 and about 1000 companies were started up. The stellar ones have been sold or IPO-ed long ago. The terrible ones have died. But a lot just limped along and have only recently started to work. However a lot of the investors in these businesses are now looking for liquidity."

In the US the "walking wounded" from the dot.com bubble years are even more pronounced than in the UK. Overall, there are about 210 era-era venture capital firms which have failed to raise any new funds since 2000, according to research by Thomson Financial.

Unsurprisingly, the limited partners in such funds are becoming increasingly eager to withdraw their money. The general partners concerned have another headache. Many took investments from a now-defunct US government programme that was managed by the Small Business Administration. The programme, which was suspended in 2005, provided twice what a venture fund raised from external private sector investors in exchange for its money back plus a small amount of interest and 10% of a fund's returns.

Now, many US venture capital funds are finding they don't have sufficient funds to repay the government its due. "A whole bunch of funds are being motivated by SBA dynamics to sell off a percentage of their ownership," Ken Sawyer, founder of San Francisco-based Saints Capital, has said. It's the sort of thing some venture secondaries players plainly relish.

In the UK 3i sold a collection of technology and early stage businesses to Saints Capital in September 2006. It then sold a further batch of 13 businesses to Shackleton Ventures in April 2008. Shackleton's managing partner Hugh Stewart is confident these sorts of deals are going to become more prevalent in the Old Continent. He says: "The market for venture secondaries is still relatively young but, we believe, is set to grow as secondaries transactions become a standard part of portfolio management in Europe." ■