

CORPORATE ACQUISITIONS

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Venture Capitalists Seek Redemption

VENTURE CAPITAL—When asked about the state of the venture capital (VC) industry, Doug Newhouse, Managing Partner of mid-market LBO firm **Sterling Investment Partners**, doesn't mince words. "I was afraid you were going to ask me about that. Venture capitalists have a whole other host of problems that we don't have to deal with," he says. "There was just such a vast over-funding there with such hyper valuations that many of them are still in trouble."

VC firms -- three years after the bull market last reared its mighty head -- are still closing up shop, and in many cases, returning money to their limited partners. **The Barksdale Group**, a Silicon Valley VC that invested in such names as HomeGrocer.com and Crossgain Corp, was no more as of early last year. Limited partners also decided to revolt against the managing partners behind now-defunct Los Angeles-based **Encore**. Legal firms which relied on VCs for business also have been damaged beyond repair: **Brobeck, Phleger & Harrison**, pressured by a slowing economy, rising debt and a lack of financing options, closed its San Francisco doors after 76 years.

Other closely watched firms have been returning money received in fund-raising rounds. Standout Silicon Valley VC **Mohr, Davidow Ventures** got the ball rolling last year by reducing the size of its seventh fund from \$847.0 million to \$678.0 million. This past December, **Atlas Venture** cut its sixth fund for the second time, from \$850.0 million to \$600.0 million, and closed its West Coast office.

With so many firms retreating, who is left to champion the industry? *Corporate Acquisitions* turned to Los Angeles-based **Kline Hawkes & Co**, which still isn't ashamed to call itself a VC firm. Its Kline Hawkes California Fund is ranked fifth out of all VC funds which started up before 1995, maintaining a 40.0-plus annualized rate of return as of Dec. 31, 2002, according to Venture Economics/National Venture Capital Association.

Klaus Koch, a Kline Hawkes principal, says that the most important rule may be don't do a deal just to do it." Kline Hawkes didn't make one investment last year, he says. The firm, which invests on average anywhere from \$5.0 million to \$10.0 million, focuses on companies with visible traction, a strong customer base, and a limited burn rate. Kline Hawkes, which also prefers to lead investment rounds, now seems ready to pounce once again: It just saw a 500.0 percent return on its \$3.0 million investment in the management-led buyout of Sterling, Virginia-based commercial security software maker **Sensor Systems**. This past February, it invested \$3.0 million in **LivHome**, a home care out-patient services company, and is about to make "a more tech-related deal" in the \$3.0 million to \$6.0 million range later this month. Clearly, valuations are more to the VC firm's liking. "In 2000, a company with \$5.0 million in revenue was worth north of \$30.0 million to \$40.0 million, but in 2003 that same company is priced at \$5.0 million to \$10.0 million," says Mr. Koch. "We are pretty much at the bottom. It was a pretty painful process for a lot of firms, but we expect valuations to come up in the second half of the year." For more information, contact Mr. Koch at (310) 442-4700 or at kkoch@klinehawkes.com.

Networking Start-Ups Attract Big-Time Attention

NETWORKING M&A—Who woke up the networking industry? Frustrated by the inability of the telecom industry to, well, do anything right, networking equipment makers have been forced to look elsewhere for growing their networks. So far this year, acquisitions are in and organic growth is out. Even Schaumburg,