THE BUSINESS OF TECHNOLOGY

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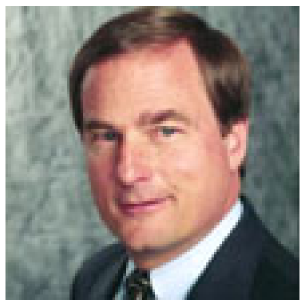
Q&A: Steve Bird on Focus

Focus Ventures' Steve Bird sees buyouts as an increasingly alluring alternative to IPOs after Citrix's buy of NetScaler and Microsoft's acquisition of FrontBridge.

August 4, 2005



Two recent acquisitions from the Focus Ventures portfolio have made the VC firm's co-founder Steve Bird a believer in buyouts. The first came in June when Citrix paid $300 million for NetScaler, a San Jose, California-based outfit peddling technology that makes web-based applications run faster (see Citrix Pays $300 M for NetScaler).

Then in July, Microsoft forked over an undisclosed sum for FrontBridge, a secure email and messaging services provider in Los Angeles that Focus had also taken a shine to as an early investor (see Microsoft to Buy FrontBridge).

Not long ago, the most vaunted route for young companies, and their backers, was going public. But with the IPO market in the doldrums, Mr. Bird and his VC peers are finding that buyouts are an increasingly alluring option or "exit" for investors.

As a Focus general partner, Mr. Bird is seeing a growing acceptance of big M&A deals among technology companies. And as a specialist in investments in the enterprise software and electronic commerce who has over 20 years of experience in VC, he should know.

Before co-founding Focus Ventures, Mr. Bird worked in a variety of venture capital jobs, including as a managing director at Comdisco Ventures and a general partner at First Century Partners. But it can be argued that Mr. Bird began his career as a geek, using his M.S. and B.S. degrees in mechanical engineering from Stanford University to get a job as a senior development engineer at Battelle Northwest Laboratories.

Mr. Bird, who also earned an M.B.A. from Stanford, recently talked to *Red Herring* about his firm's recent acquisitions, the IPO market, and the latest deal trends in technology. Edited excerpts of his comments follow:

Q: Your firm has recently sold both NetScaler and FrontBridge. Are you excited about the opportunities in the M&A market?

A: Very much so.

Q: No disappointments that they didn't go public?

A: No, actually not. Not in this environment. Our sense is that the public market, the IPO market at least, for private, emerging companies has not been particularly strong over the last couple of years for a whole variety of reasons.

So we actually believe that M&A transactions are going to be a pretty good exit option for many of these venture-backed companies.

Q: Why do you say the IPO market has not been strong?

A: Well, first of all, there haven't been that many [IPOs]. The ones that have gone public have tended to be very old companies that are very, very large. And I suspect that part of the reason is that public investors have not been very excited about investing in emerging-growth technology companies, given the hangover from the bursting of the bubble.

I suspect that some of the compliance issues with [corporate governance legislation] Sarbanes-Oxley have had some effect. Again I'm not sure what all the reasons are, but the last two years have not been good at all for venture-backed IPOs.

I just saw some data that as weak as 2004 was, 2005 will be even worse.

Q: Is it something different in the market, or is it just that the companies aren't any good?

A: Well, I think the companies are good. We actually see a tremendous amount of high-quality companies today. As a matter of fact, we have about 30 private companies in our portfolio and they're going to do about a billion dollars in revenue this year with something like 60 percent year-over-year growth. And that's just our portfolio.

So clearly there are quite a number of very significant, very successful companies. I think it has more to do with the IPO market itself. I think there are plenty of high-quality companies. I just think that IPO investors have tended to shy away from technology after they were so badly hurt when the bubble burst.

And I think some of the compliance issues have made companies reluctant to go through the IPO process. Those are at least two factors that have put a lot of pressure on venture-backed IPOs.

Q: So you're saying you would have gotten better valuations for your companies by doing M&As?

A: Exactly. We're very excited about the M&A path for both of those companies.

Q: That seems kind of strange. What do you think leads to better valuations in the private market?

A: One is the factor we just talked about. The IPO market has been a bit soft, which has a negative impact on the valuations you get.

The other huge factor that really drives the M&A process is the strategic synergies you can get. Because if you have a $50-million-a-year revenue, venture-backed company that goes public, it might grow at 30 or 40 percent each year and you might get a decent return.

But if you take that same $50-million-a-year company and sell it to Microsoft or sell it to Citrix, it could double or triple in the next year. I think because of the distribution channels and the customer base the strategic acquirers have, they can create a tremendous amount of leverage for these small, venture-backed companies and enable them to grow much more quickly. And therefore they're able to pay pretty substantial valuations relative to what the company could earn as a standalone company in the public market.

Historically, many companies in the technology sector did not believe M&A was a good way to grow. They felt that knowledge companies were really driven by intellectual property and intellectual property was driven by people. And they couldn't hang on to the people. So for most of the last two decades that I've been in this business, people were a little bit shy about doing big M&A transactions because they didn't think they could retain the value.

I think John Chambers and Cisco have changed that dynamic. They've demonstrated that in fact you can be successful and you can build value through acquisitions. The more that I think about it, that factor has changed over the last several years as well. People now believe that it's a successful strategy to pursue M&A to grow the business. It used to be that that wasn't the case.