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OUT OF THE WILDERNESS

After seven years of frustrated ambitions, MTI has succeeded where most have failed – raising a seed capital fund. Now comes the hard part.



It's been seven years of hard labour since MTI last closed a fund – a stark indication of the state of Europe's venture market. After a period of reflection and a change of approach, David Ward (left) and Ernie Richardson have bought MTI back into the early-stage venture business.

WORDS **GUY FRASER-SAMPSON**
PHOTOGRAPHY **CHARLIE HOPKINSON**

COMEBACK **KIDS**



FOR SEVEN LONG YEARS, high-quality venture firms have despaired of finding someone who is even prepared to listen to their story – still less take it seriously. Many have simply faded away into the sepia tint of obscurity that begins to cloud our memories of the internet bubble. All the more reason, then, to sit up and take notice of the fact that not only has MTI raised a new fund, but that a genuine seed fund that will be managed by professional, experienced venture capitalists has been raised in the UK.

With the exception of Eden Ventures (another prodigious feat of fundraising stamina and determination) one probably has to cast one's mind back to the Amadeus Seed Fund to find a similar example – and that was raised at the height of venture fundraising enthusiasm.

Moreover, the Amadeus Seed Fund was only about £10m (€12.7m), and was always designed to hand opportunities off to other funds fairly quickly. It was also designed to work alongside the UK angel community, particularly in and around Cambridge.

But MTI's UMIP Premier Fund (UPF) is different both in its scale and its conception. The UMIP part of the name signals a primary focus on intellectual property spinning out of the University of Manchester – but this is no straight university seed fund, like Imperial Innovations.

University staff will play no part in the final decision-making process; only those projects which play to the core competencies of MTI will be considered; and experienced venture partners will contribute sales and marketing expertise. MTI's US office in Boston is also expected to come into play, both assisting with business development and attracting co-investment from US venture firms as companies develop.

Size is a factor too. The fund has raised about \$65m (€41m) – with a final target of \$100m – which gives it the capability to undertake significant seed-stage funding itself, without having to resort to angel rounds. However, it remains to be seen how a scenario in which they are the only professional seed investor of any size in a particular market will play out. Logically, one would not expect them to look to deploy more than about \$3m into any one company.

Managing partner Ernie Richardson, a long-standing stalwart of the UK venture scene, is bullish on this point. "University of Manchester spin-out companies have attracted £200m of funding in the past 12 years," he says. "This shows very clearly that, even given the admitted shortage of seed providers in the UK, the money is there for successful and exciting projects."

It is heartening that the UPF attracted commitments from UK pension funds – though sadly not from any international funds of funds. CIS and Greater Manchester Pension Fund have invested, alongside sources such as the European Investment Fund and the National Endowment for Science, Technology and the Arts.

However, while the successful fundraising represents a beacon of hope for the industry, it shines through an enshrouding gloom in which venture fund offerings, such as MTI's own ill-starred Fund V, flounder in a sea of investor apathy.

"We spent one and a half years trying to raise fund five," says fellow managing partner David Ward, who runs the firm's Boston office. "As others found to their cost, the environment simply wasn't ready for the story we had to tell in 2005. You can only bang your head against a brick wall for so long, so we decided to go away for a while and come



back once market sentiment had changed a bit.”

The delay has given an opportunity for a major strategic re-evaluation of where the firm should be positioned. UPF signals a commitment to very early-stage investing – itself a rarity in the UK. However, Richardson acknowledges a factor which bedevils such operations: “In order to run a quality fund management operation, we need assets under management of about \$400m,” he explains. “The problem is that if you raise all that in a single fund you will inevitably be pushed later-stage in order to put the money to work. This is not an issue in America, where both entry valuations and round sizes are much higher, but here in Europe it would make it very difficult for us to keep the very early-stage focus.”

Safety in numbers

The solution they have seized upon is to raise more than one fund, each with a slightly different stage focus. It is hoped that this will also make fundraising easier, since most LPs are even less inclined to listen to a seed-stage story than to any other venture fund pitch. MTI will accordingly shortly go to market with MTI 6, targeting between \$150m and \$200m. This will still be an early-stage fund, but will be designed to handle the A and B rounds of MTI portfolio companies.

Along with the new fund will go a new investment perspective. Historically, the firm pursued opportunities predominantly across the IT sector but also made investments which, for want of a better description, many have dubbed “specialist engineering”. Ironically, it is these investments – seen by some LPs as unexciting when considering offerings in the heady days of the 1990s – that have proved most successful, and where MTI now seeks to focus its efforts.

For example, ApaTech, an MTI company that makes substitute bone material for synthetic bone grafts, recently came top of its class in *The Sunday Times* Tech Track 100 survey. It points the



high-tech manufacturing processes, but also the very complex systems that enable their use. This was another 2004 investment – well remembered as it closed on Christmas Eve – which now has sales of around £10m and has won engineering accolades including the Manufacturer of the Year for 2007 at the Elektra Awards.

It is in these two main areas – materials and med tech – and in their areas of convergence, that MTI now intends to seek its own and its investors’ fortune. Richardson cites the environmental and healthcare markets as those in which opportunities of meaningful market size are most likely to emerge.

By contrast, Global Silicon is an example of the sort of IT deal that MTI traditionally pursued, but where success proved elusive. Global Silicon was a fabless chip company and MTI, together with other venture investors, lost their money when it was closed down in 2006.

Richardson is candid about the lessons they learned from this and similar deals. “First, it was apparent that the company never had enough

changed, thus prompting a move into what Richardson refers to as “a 21st-century venture partnership model”.

Debate continues in the industry over whether a “hard core” version of the US venture model can or will work in Europe. Is the Israeli model of moving venture companies to the US desirable? Many have found difficulties with this, but others, such as Pond Ventures, enthusiastically espouse it. Is the European angel community wealthy enough and robust enough to play the same sort of role it does in the US? Do European governments and society actually want a venture community at all? One senior financial executive said recently “at best, they tolerate it”.

Just money

Many believe that it is possible for a variety of different venture models to prove successful in Europe. For example, Skype was not a product of the US venture model being applied – on the contrary, on the admission of its own venture backers it was what the Americans would call a “just money” investment. Others believe that a different sort of model will emerge; Americans fail to realise, for instance, that because of dramatically lower entry valuations in Europe, an exit of a few hundred million dollars can produce a 25-times return home run – as opposed to the several billion dollars required in the US.

One thing at least is now assured. MTI, one of the oldest names in the business, will be at the forefront of the debate, and will be putting its own ideas into practice. It is too early to give three rousing cheers for them and for European venture; that will only come when European firms begin consistently to produce acceptable returns and when European LPs stop taking their mind-control drugs.

It is though, appropriate to offer two cheers. It is MTI – and the other hardy few who have braved investor displeasure simply to survive in business – who carry the hopes of European venture for the future. This is an experiment which cannot afford to fail. No pressure, chaps. ●

GUY FRASER-SAMPSON set up and ran the international operations at Horsley Bridge and is the author of *Private Equity as an Asset Class*.

“ We spent one and a half years trying to raise fund five. You can only bang your head against a brick wall for so long ”

DAVID WARD, MTI PARTNERS

way to the sort of deal the team hope will form the bedrock of its portfolio in future. Originally funded by MTI as a spin-out from Queen Mary, London, in 2004, the company now has a US subsidiary, sales of £7.5m, has reached cashflow break-even and is building towards an exit. More flexible venture labelling would probably allow this to be called a “med tech” or possibly a “materials” business.

Another example of materials might be PowerLase, although this also has overtones of what might 20 years ago have been called “production engineering” or even “machine tools”. The company designs and supplies not just the solid-state lasers required for various

money to be truly competitive on a global scale,” he says. “The basic problem here was that all its VC backers were investing out of very small funds. Second, it was a business that needed to be global but was backed predominantly by UK players. And third, if we are really honest with ourselves, it was not a good fit for the operating expertise of our own team members.”

The team is addressing the first two problems with its new fundraising strategy and the recent opening of a Boston office. The third problem is more intractable, and has driven them to move away from this sort of investment in future. Unspoken, but definitely hovering in the background, is a belief that the venture world has