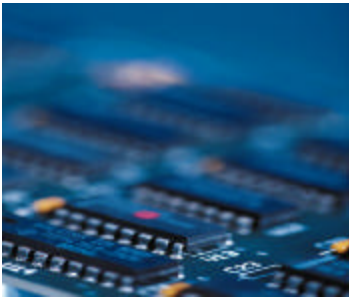


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GAZELLE START

Gazelle Outlook

Insights into Strategies and Directions

Band of Angels HANS SEVERIENS

Hans Severiens, PhD

Managing Director, Band of Angels

Dutch-born Hans Severiens is a rare breed: a nuclear physicist turned investment banker, turned venture capitalist. Founder of the Band of Angels, Mr. Severiens started his career as Assistant Chief Scientist at Perkin-Elmer, and worked at the U.S. Atomic Energy Commission, then became Vice-President Investment Banking at Morgan Stanley, before joining Merrill Lynch. Since 1983, he has been closely tied to the Silicon Valley high-technology investment community. In 1995, he founded The Band of Angels, and is its Managing Director.

The Band of Angels is a formal group of 150 former and current high tech executives and entrepreneurs who provide counsel and capital to startup companies. Companies that receive investment also receive the benefits of contacts and mentorship from the same people who helped build Silicon Valley. Band Members have founded companies such as Cirrus Logic, Symantec, National Semiconductor, and Logitech, and have been executive officers at Sun Microsystems, HP, Intel, 3Com, and Intuit. Institutional support for portfolio companies, such as bridge financing and follow-on rounds, is provided by the Band of Angels Fund, L.P., a venture capital fund made up exclusively of institutional partners, and by the numerous venture capitalists with close ties to the Band. To date, over \$400 million has been invested in subsequent rounds by institutional sources such as the Band of Angels Fund L.P. and other VC and corporate entities.

Gazelle Outlook sat down with Hans Severiens to discuss his insights into the strategies and state of the market.

Through its eight years of existence, the Band of Angels, that you founded, made multiple investments in California. With a full cycle experienced up to now, could you tell what average annual return your fund yielded?

There is no simple answer as there are two entities that invest under the name of The Band of Angels:

First, there is The Band of Angels, a group of about 150 individual investors, who all spent their career in high-technology companies in the Silicon Valley, in senior positions. This group has been very stable so far, with only a dozen investors that left, replaced by another dozen. In the last eight years, these investors have closed approximately 150 investment deals in startups. Today, most of these companies are still privately held, making the computation of an average return difficult, if not meaningless. Our investors, who invest individually and not as a group, generally invest between \$50k and \$100k in each company they elect to participate in, according to a price, terms and conditions agreed between the target investment company and the band of Angels who generally structures the financing round.

Second, in the last three or four years, we decided to develop a more formal investment tool, with a big pot of money allowing us not only to bring to the table significant funding, but also to add the capabilities of participating in follow-up rounds. We then founded the Band of Angels Fund L.P., whose limited partners are mainly U.S. institutions, except for two institutions, including a German ven-

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ture capital fund. The fund was closed with \$50 million, and its first investments started about two and a half years ago. Since inception, we are down 18%, which is not uncharacteristic for the early years of a venture capital fund: returns generally follow a J curve and we are obviously at the beginning of the J curve. In the first years, you do record a certain number of failures, and it takes time to cash in on the winners, who generally multiply their valuation by a factor of ten or twenty at the time of the exit.

What are the major criteria in your investment decision?

As we invest in early stage companies, we are very much focusing first on the quality of the individuals that found the company: initially, one of the founders has to act as the leader, the Chief Executive Officer, and we have to be impressed by him. This individual has to be very proficient technically, because we invest in a pre-product stage. Having a good marketer among the founding team is obviously a plus. As companies evolve from one stage to another, the leadership moves to the sales and marketing function and then, in a third stage, to general management. The second important criterion is the market potential: the market has to have a significant size. Lately, we have added another criteria: the availability of follow-up money from the venture capital investors.

A lot of analysts are saying that angel financing has replaced the seed funding that used to be done by venture capital funds in the seventies and eighties. Is this a true state-

ment?

It is true, and we have been the first to recognize that. Angels have replaced the early venture funds: In the seventies, the Sequoia Capital and Kleiner Perkins funds were investing in early stage deals, and their general partners were mostly technology people. Today, the partners in these firms manage very large funds, with a mix of MBA-educated people and engineers, and they have shied away from the early-stage ventures. We filled that gap very naturally with our hands-on, friendly attitude with entrepreneurs who consider us as their mentors.

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Historically, angel funding in the U.S. has represented a larger pool of financing for technology companies than venture capital. Did the trend accelerate in the last two years?

Statistics in this field may be confusing: they generally originate from the Bureau of Commerce and include a hodge-podge of new companies from laundry shops funded by family and friends to highly sophisticated technology companies. But yes, the trend is right, and angel investing is here to stay.

Since the spring of 2000, did you witness a change in entrepreneurs' expectations as to what they are building, and hence a quality change in the deal flow?

The quality of the deal flow has risen considerably, and financial ex-

pectations of entrepreneurs have diminished significantly. The timeline for an early-stage investment to yield a return is longer today than it was three years ago: it is reasonable to expect 6 to 7 years before maturation. We see more rounded, mature entrepreneurs with their feet on the ground. We are back to what angel investing was before the "bubble".

Can you describe the typical involvement you take in the companies you invest in?

We are fully committed and act as mentors of the founding team, participating with them in all strategy and brain-storming meetings. We introduce them to relevant contacts, and assist them in identifying and hiring additional members in their team.

Do you preferably introduce the successful companies in your portfolio to a select group of venture capital firms you have come to appreciate, or do you sometimes advise CEOs to seek funding beyond the long established investors of the Silicon Valley?

Twice a year, we invite the venture capital community, friends and family to a large party, gathering 300 to 400 people, because relationship is extremely important. We are hands in hands with venture capital funds, and having worked together develop a trust in the way both parties do business and deal with investments. Make no mistake however: general partners at venture capital firms make their own decision according to their own needs. Each deal has to stand on its own feet. We can certainly open doors for entrepreneurs

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as our brand name is well recognized. In this respect it may be a plus for them to have us around as initial investors.

When the capital markets -both for IPO and M&A- are anemic, do you find it harder to share investment positions with venture capital funds that may have different horizons that your group? Are there more conflicts today about the future of some investments than in the late 90s?

As angels, our horizon very often is 7 to 8 years, whereas venture funds could be in the late years of one fund and have a horizon of less than two years in the same investment. Typically, a fund life is about 8 years, but the policy of the funds is not to disclose to the invested company the remaining years in the fund, so it is impossible for us to know exactly what kind of horizon the venture investors have. The potential "conflict" arises from psychological differences: an angel can only blame oneself for the loss of an investment in case of failure, while a general partner in a venture capital firm has to report the bad performance of the investment to his partners, who may sanction him or her with the loss of his or her status as a general partner in the firm!

Very few small foreign companies in high technology have become durably successful in the US market in the last twenty years. What are the main reasons you estimate account for the failures?

I have some experience in technology transfer from the U.S to Europe, having worked for a Netherlands

technology fund in the U.S. First of all, there are some foreign successes in the U.S. like Checkpoint Software, but it is true that in most cases, foreign management shows a lack of understanding of what the marketplace in the U.S. needs: marketing a product successfully in France or in the Netherlands does not mean you can be successful all over the world with the same

product. You have to change the product more often than not, and remain close to what U.S customers look for. Japanese companies seem to have been more successful than their European counterpart in reaching the U.S. market. The way Japanese car manufacturers studied the U.S. market and did a better product marketing than US car manufacturers themselves is remarkable. Large European groups, such as Philips and Siemens have realized that this is a market that requires specific products, and more importantly a flawless servicing.

What lessons learned from your investment career in technology would you share with us?

It is a very difficult game. Business plans you receive are all very beautiful, but the reality is there are always things that go wrong, and enterprises need a lot more money than what is anticipated

in their plans. Entrepreneurs have to carve a "disaster plan", ready to be implemented at any time.

Are there certain areas in your opinion where foreign companies could have an edge in the US (if the market is approached appropriately)?

Foreign technology is generally as good if not better than in the US in many countries. If you take a look at Checkpoint Software, they got the bigger traction out of the US market. They became perceived as a US company. They play according to the rules of US corporations. Of course, there are some egos on the way that are disturbed. The real problem for foreign companies is more of a psychological nature: entrepreneurs in these companies can access the US market only with the right mindset. They have to accept what this large market dictates.

What technology areas do you think are still under-funded? Over-funded?

Wireless, networking equipment, part of the semiconductor technologies have been over-funded in recent years. Technologies and companies that are not in the popular mainstream are under-funded: for instance, we invested in a company recycling all sorts of plastics. It is very difficult to get the attention of venture capital funds, as they have a different dynamics. We also consider the medical devices space to be under-funded. As a startup in this field generally needs a lot of funding to get to market, it has been overall difficult to get many of them off the ground. In the energy space,

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companies that are funded hardly reach the much sought after IPO exit: the usual exit is a sale of the company to a larger energy group.

Would you invest in a foreign company with a good technology, a good management team, in a fast growing emerging market, if they would set up their headquarters in a 50-mile radius from your base?

Yes, the key for them being to set up their headquarters close by.

What advice would you give to "gazelle" foreign companies that attempt to penetrate the US market?

The foreign company needs to become a US corporation: shares should be denominated in dollars in the long-term view of a US I.P.O. Management should focus heavily on market positioning issue, pricing, the advertising has to be right.



About Gazelle Outlook

Gazelle Outlook is an ongoing series of conversations with leaders and experts around the world to give you insights into the emerging opportunities in the US Market.

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