Getting Ahead of the Curve:

Companies, their Constituents, and the Pervasive Need for Liquidity in the Venture Capital Ecosystem

By Dan Burstein and Sam Schwerin, Millennium Technology Ventures

During the IPO drought of 2008, the $400 billion venture capital ecosystem became extremely thirsty for liquidity. Mid-way through 2009, it is perhaps more appropriate to say the market is not just thirsty, but absolutely parched—and in danger of systemic dehydration. With exactly zero venture-backed companies achieving IPOs in the first quarter of 2009, and only six venture-backed companies having IPO'd in all of 2008 (down 92% from 2007); with more than 125 promising companies having recently withdrawn their IPO filings; and with the M&A market hovering near its historic nadir in volume as well as dollar size of acquisitions, new paths to liquidity need to be found.

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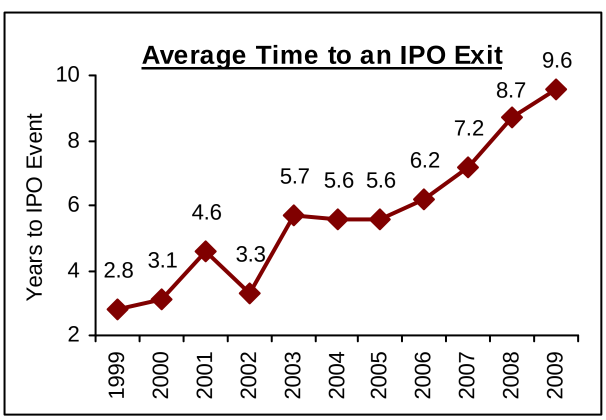
Venture-backed companies have historically been built with the dream and the goal of achieving the big IPO someday. But statistics from the National Venture Capital Association suggest a systemic, long lasting challenge to that goal. Even the best venture-backed companies—the ones that actually attain the holy grail of the IPO—now take an average of 9.6 years to get there, a gestation period that has steadily lengthened year-by-year throughout this decade, even in the brief periods of bull market conditions. With the rest of 2009 shaping up as another weak year for IPOs, the **average time from first investment to IPO is likely to be 10+ years by the time the IPO window next opens.** Even that statistic is success-biased to the handful of companies that make it through the eye of the IPO needle. There are literally thousands of good, strong, growing technology companies for which there are no obvious IPO or M&A exits any time in the foreseeable future.



Quite apart from the current atmosphere of financial distress, 10+ years is too long for almost any constituent, even the most institutional and patient, to wait for a liquidity event. What's more, the IPO itself is no longer the liquidity event it used to be. With locks-ups and the vicissitudes of public markets, the mere achievement of an IPO doesn't equate to a successful exit—

85% of the 76 venture-backed companies that achieved IPOs in 2007 (the best year for IPOs since 2000), are today trading below their IPO price. Most of the original constituents in these capital structures did not exit fully or at all at the time of the IPO.

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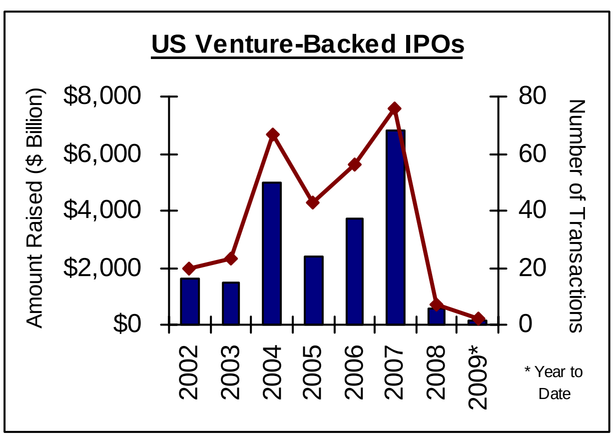
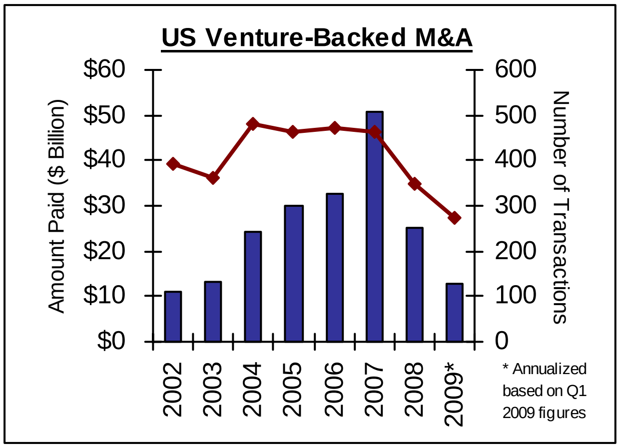
An increasing challenge for many venture-backed companies is this one: **What to do with all those investors, shareholders, and other constituents in their capital structures who lack the access to capital and the institutional patience of the core venture investors?** In almost every venture-backed company, there are many more non-core, non-institutional investors and shareholders than there are institutional venture capital funds. These are important constituents—founders, management team members, employees, former employees, angels, consultants, warrant and option holders of different types, along with a variety of inadvertent participants such as hedge funds, private equity investors, lenders and strategic corporate partners. And they all need, want, expect, and appreciate liquidity earlier than ten years into their involvement, especially in the current environment of overall market and economic crisis. Yet the cost of accelerated liquidity, i.e., selling a Company too early, where it's even possible, often comes at a substantial sacrifice to the maximization of aggregate shareholder value. The average sale value of venture-backed companies in the first quarter of 2009 was only $47 million.



As venture capital continues to evolve as an asset class, it needs to develop alternative paths to liquidity to meet the needs of these various constituents and to avoid 10 years of uncertainty. That's where the secondary market can play an important role.

Our firm has been able to work with many companies to create formal and informal liquidity programs for employees, management, non-core investors and other constituents, who need or desire early liquidity on some or all of their shares. We have been able to do this even in the very best technology companies, where the eventual success for shareholders is likely to be substantial.

Smart, successful management teams and boards at great private companies increasingly recognize organized secondary liquidity programs as their opportunity to combat systemic liquidity headwinds. Such secondary programs can afford management valuable tools to control the flow of liquidity to shareholders proactively on company-defined terms. Through the right kind of secondary liquidity program, CEOs and CFOs gain the ability to choose a patient, value-added, institutional quality liquidity partner, rather than accept any willing buyer as a new shareholder. Liquidity programs can be highly customized to meet the needs of specific shareholders, in structures ranging from a shareholder loan or a tender program, to employee (or departing employee) liquidity programs that take place over a number of quarters or years. These organized programs offer companies and their investors powerful new and efficient tools to get ahead of the curve by better aligning shareholder interests, accelerating liquidity to those who most need or desire it, and maximizing value over the increasingly long life of venture-backed companies.



Our firm has been fortunate enough to become the institutional, trusted liquidity partner for an increasing number of the companies in the venture capital ecosystem who need creative liquidity solutions. In return, of course, we are building up a portfolio of some of the best venture capital investments that can possibly be made today—in great and growing best-of-breed technology companies that will be among the big winners when the market cycle evolves and the next liquidity wave hits from renewed IPO and M&A.

Even against the backdrop of a market where many observers see gloom and doom, we have been able to create "triple win" situations. These are:

- Wins for employees and others receiving early liquidity,
- Wins for the companies and their investors who are solving internal pressures and problems by allowing for early liquidity but not having to pay for it or compromise the long-term aggregate value of their company, and
- Wins for our funds and our investors by gaining ownership stakes in important leadership companies.

About the Authors: *This is an expanded and adapted version of an article that appears in the Dow Jones Private Equity Analyst 2009 Guide to the Secondary Market. The authors, Dan Burstein and Sam Schwerin, are Managing Partners of Millennium Technology Ventures. Millennium specializes in providing innovative liquidity solutions to venture-backed companies, their founders, management teams, employees, institutional investors, and other constituents. Through more than 200 transactions over the last decade, the firm has developed unique expertise in the direct secondary market for venture capital and growth equity assets. Millennium's best-of-breed portfolio companies over the last decade have included Tellme Networks, Wayport, ArcSight, Airvana, Facebook, eHarmony, Zappos, LiveOps, and many more.*

Prior to Millennium, Sam Schwerin worked in private equity and M&A at investment firms including The Blackstone Group and Salomon Brothers. He has also helped found several successful emerging growth companies. Dan Burstein was Senior Advisor at The Blackstone Group for 12 years prior to founding Millennium in 2000, and has been making venture capital investments since 1983. He is also a bestselling author, having published 13 books on global economics, new technology, and popular culture. To learn more about Millennium visit: www.MTVLP.com

This is right where you want to be.

Working in the secondary market since its inception, **Millennium Technology Value Partners** creates innovative liquidity solutions that are responsive to today's challenging environment.

Millennium Technology Value Partners specializes in creating customized, innovative, flexible liquidity solutions for holders of venture capital investments and other illiquid private equity assets.

We have partnered with sellers in more than 200 transactions over the course of a decade to generate liquidity and meet other seller needs. That success in solving complex problems has led more than 80% of sellers who initially work with Millennium to return to us with additional transactions.

Our transaction partners have included some of the world's leading hedge funds, mutual funds, investment and commercial banks, technology companies, industrial companies, and venture capital funds. We have also designed liquidity programs to meet the needs of individuals—business founders, CEOs, senior executives, and angel investors. We are buyers of investments both large and small, from distressed to pre-IPO situations.

We are working in the secondary market every day to create new opportunities and efficiencies for holders of venture capital assets to achieve liquidity on illiquid assets and to help venture investors re-balance their portfolios and adjust risk/reward equations.

If you want to harness the power of a whole new world of liquidity solutions from Millennium, contact us.

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