
General Partners: VC

For Industry Ventures, Downturn Is Same Song, Second Verse

By Russ Garland

Liquidity demands in the aftermath of the dot-com bubble tugged **Industry Ventures** to its current orientation as a secondary investor. The latest economic downturn presents an even bigger opportunity.

"It's almost like we're reliving the experience, only this time it seems like it's worse," said Hans Swildens, principal and founder of Industry Ventures.

The San Francisco firm got its start investing directly in start-ups in 2000 out of a small fund raised mainly from individuals. But it found buying other investors' stakes in companies and funds more attractive after the technology bubble burst. Industry Ventures raised two more funds from individuals and then closed its first institutional fund in 2005. Its most recent fifth fund is more than double the size of its predecessor, closing at an upwardly revised hard cap of \$265 million.

Industry Ventures purchases both stakes in companies and in funds, splitting its capital roughly evenly between the two strategies. Swildens sees an acute need for secondary capital in both areas at the moment. For funds, limited partners face serious liquidity constraints. For companies, venture funds raised during the Internet bubble are nearing the ends of their lives and need to find exits, but both the initial public offering and merger and acquisition markets are weaker than they have been in years.

Until about a year ago, Industry Ventures bought most of its direct company stakes from corporations, hedge funds and family offices. Lately, financial institutions and venture partnerships winding down funds have joined the pack. In several deals, even established venture firms without capital needed for follow-on investments have sold Industry Ventures stock strips of 10% to 15% of their holdings in later-stage companies.

"The sellers are all types when historically it was one or two types of the capital structure that would be selling in any one year," Swildens said.

On the LP side, the firm has seen the same expansion, from the wealthy individuals and corporations it typically dealt with to pension funds, advisory firms and even a few funds of funds.

While many venture firms are hoarding capital, Industry Ventures completed more than 40 acquisitions of companies and fund stakes in 2008, up from 27 the prior year, including the purchase of nine funds from bankrupt Washington Mutual Inc. earlier this year. It expects to deploy the new fund through the end of next year, although deal pace has slowed somewhat lately due to pricing uncertainty. Swildens said venture pricing follows the Nasdaq, but portfolio values have only lately begun to reflect that. "If you're a buyer...even if you pay 30% off you might be in the red in six months because the fund might mark itself down 40%," he said.

The paucity of exits is also reason to take care. Since September, Industry Ventures has bought interests in 25 venture funds and received distributions, small ones, from only three of them. "Historically, that was not the case," Swildens said. "You would have distributions every quarter or every other quarter out of a venture fund interest that was at least five years old." Now, "you have to pay a lower price because you're taking more risk."

Nonetheless, Swildens sees this as an opportune moment to do some good deals at the right price. "We know the companies and we know the general partners pretty well," he said. "We're trying to find those opportunities where there's companies and investors and general partnerships that go out there and build good, big, valuable companies because right now is a good time to do it." ■

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Industry Ventures

The Firm

Based in San Francisco, Industry Ventures has three principals including founder Hans Swildens. It's mainly a technology investor but does do some health care deals and is starting to look at cleantech deals, which are just beginning to come into the secondary market. In the next few years, Swildens expects to see China and India deals as well. "It's a very predictable market," he said. "It's like a used car."

The Fund

The firm closed Industry Ventures Fund V LP in March at \$265 million but it could command up to \$250 million more through side funds from its LP base or strategic investors. These co-investment funds are designed to enable Industry Ventures to do deals that require more than 10% of the main fund; Swildens said the firm is seeing more such opportunities. The firm had the same capability with its \$107 million prior fund and wound up committing a total of \$125 million through the main fund and two side funds.

The Focus

Industry Ventures can invest up to 25% of its fund outside of venture capital. It did one such deal earlier this year, buying part of a technology-focused hedge fund. But such deals will be the exception, Swildens said. When a secondary transaction involves private equity investments as well as venture, the firm typically brings in one of its 20 LPs to buy the PE piece.