

Venture Capitalist - Now's Time To Invest In Tech.

By JAMES DETAR

10 March 2003

Investor's Business Daily

Subscription Only

Q & A

Tech venture capital investing fell off the charts after the dot-com bust. But venture money is starting to trickle back into the market.

One reason, say some analysts, is that parts of the tech sector are ready to grow again.

Gartner Dataquest, for example, says it expects chip sales will rise 9% this year to \$167 billion.

William Quigley is managing director at Clearstone Venture Partners, a Menlo Park, Calif., tech venture firm. He specializes in computer chip and communications start-ups. Quigley says now is a good time to invest in some tech segments.

In an interview with IBD, Quigley talked about what's hot.

IBD: What's the overall climate for tech venture funding?

Quigley: People have written a lot of stories about the rise and fall of the venture capital market.

While we hit a low in 2002 in terms of new company formation - early-stage first-round investments - in 2003 we will start to see an uptick.

Most technology companies require 18 months to two years to get their products ready for the market. If people anticipate stronger technology spending in 2005, now is the time to start placing bets.

IBD: How much has venture investing bounced back from the crash?

Quigley: The VC community has started to sort out which products will be in demand.

IBD: Which ones do you think will be in demand?

Quigley: Semiconductors are attractive again, particularly in some areas of the telecommunications business.

IBD: In what fundamental ways has investing changed in the last couple of years?

Quigley: For VCs, the days of investing and seeing a return two years later, and then liquidating some of their investment a year or two after that, are gone.

Before, it wasn't uncommon to go public in two years. Today it will take five to seven years before either someone buys that company or it goes public. IBD: What's your overall investing strategy?

Quigley: You can't look at current areas and anticipate future needs. You have to look out beyond that. The fact that the semiconductor industry had a very bad 2002 is not terribly relevant to VCs.

IBD: How much risk are you willing to take?

Quigley: Market risk is our primary focus when we fund a company. We ask: What are the drivers for adoption of that product and what's the timetable for adoption? How big is the market? How many competitors are vying for a piece of that market?

IBD: What other investing areas do you find attractive?

Quigley: In the security space, there's what I would call semantic processing. It's products that will enable the enterprise to protect itself against viruses, like Code Red and Nimba.

Security chips aren't yet able to quickly detect unauthorized Web traffic. As a result, the vast majority of companies today don't have sufficient security.

A lot of companies are being funded to provide the ability to process Web traffic security checks at very high speeds.

IBD: At what point do you expect a company you invest in to start making money?

Quigley: (For semiconductor companies) the magic number a firm needs to get to is to produce a chip with \$10 million and break even with no more than a \$30 million investment. Those types of parameters are more difficult for a large organization. The benefit is its management can move a small company faster than a big company.

IBD: Do you think Web companies will continue to go under?

Quigley: I don't see that on the consumer side. United Online.com (parent of low-cost Internet service providers Juno, NetZero and Bluelight.com), for example, is a company that many wrote off after the telecom bust. Many said any company that was an Internet service provider couldn't be profitable.

Now they have a \$551 million market cap, up from \$200 million a year ago. They are growing subscribers to the tune of several hundred thousand subscribers a quarter. They have in excess of 50% gross margin on their ISP service.

IBD: Why do you think United Online is doing so well?

Quigley: They charge less than \$10 a month. That's half of what the three leading ISPs - AOL, MSN and EarthLink - are charging. Those three attempted to migrate to broadband, which I think is extremely unprofitable. You need a technician to put it in your home.

IBD: Are you investing in wireless handheld companies?

Quigley: I'm interested in that area as well. The graphic chip business is another. Today, consumers are constantly demanding improvements in the visual experience of games and PCs.

IBD: Graphics chip companies have been depressed for a while, though. Why invest there?

Quigley: I look at the next generation. It's a never-ending cycle to meet next-generation products for companies like Sony that will need faster chips. I tend to look out two to three years, not the last six months or the next six months. The fact that graphics chips have been sluggish doesn't concern me all that much.

IBD: Do you think by the end of this decade venture investing will return to the levels of the late 1990s?

Quigley: I don't think that's possible. The confluence of the excitement of the Internet and creation of the CLECs (new regional telephone companies) after the telecom reform act of 1996 led to an unparalleled spending environment.

I would suspect if we see a nice increase, say to double-digit growth, it won't happen until the latter half of the decade, maybe 2008 or '09.