



FILE PHOTO

At a recent event, Michael Gorman explained how merger and acquisition activity ties to venture capital. He's overseen two acquisitions in three months.

VCs predict boost in funds tied to increased deal flow

BY SARAH STURMON DALE
CONTRIBUTING WRITER

After months of inactivity, Michael Gorman, managing general partner for St. Paul Venture Capital, is finally seeing signs of life.

Gorman has overseen the acquisition of two Minnesota companies — HighJump Software Inc. and Sistina Software Inc. — in the past three months.

That, he and others say, is good news for the future of venture capital activity in Minnesota and across the country.

"Companies are starting to feel bullish," said Gorman. "The lack of liquidity over the last three years has been a significant constraint on the market. But now, mergers and acquisitions are returning."

Activity in mergers and acquisitions has a big impact on venture capital activity. When venture capitalists make an investment, they are looking for an exit strategy — in most cases an acquisition or a public offering. But in the past few years, mergers, acquisitions and IPOs all have declined. That means the venture capital that was invested in companies stayed there and wasn't available for new deals.

"It is all a matter of confidence. Raising money has been a lot easier in the last six months or so than it has been in the past two

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2003 Venture Capital Activity

National: \$18.2 billion to 2,715 companies
Minnesota: 58 companies received \$203.8 million
National breakdown: Software captured \$3.6 billion, 20 percent of all investing; biotechnology, \$3.4 billion; telecommunications, \$2 billion; networking, \$1.7 billion; semiconductors, \$1.2 billion.

Minnesota breakdown: Five firms in the medical devices and equipment category collected a total of \$36.8 million — about 80 percent of the total venture capital.

Source: MoneyTree survey conducted for PricewaterhouseCoopers, Thomson Venture Economics and the National Venture Capital Association

years," said Paul Crawford, president and CEO of Minneapolis-based Crawford Capital Corp.

Some venture capitalists are wary, for example Paul Knapp, senior vice president of Roseville-based Space Center Ventures Inc.

"I think for at least the next year we'll continue to see fewer investors, less money and see the focus on emerging companies achieving a positive cash flow," he said. "It's on the uptick, but it's a long way from anything approximating the brisk exits that occurred in 1999 and 2000."

M&A REPORT

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According to the MoneyTree survey, conducted for PricewaterhouseCoopers, Thomson Venture Economics and the National Venture Capital Association, 58 Minnesota companies received \$203.8 million in venture capital in 2003. That is the lowest dollar amount that has flowed into the state since 1996 and represents about 1.1 percent of the nation's total venture capital pot.

But experts say that the environment is finally changing.

"There are a number of encouraging signs," said Gorman. "There has been a broad economic improvement; the Nasdaq has rallied; there has been an increase in IPOs and registrations and an increase in merger and acquisition activity. All of that is good news for the venture capital future."

Sima Griffith, a founding partner of Minneapolis-based Aethlon Capital, said Aethlon has reviewed at least 25 companies in the past few months — either because they are looking for financing or to be bought out.

"It's no longer frigid," she said with a laugh. "The waters are warming up and we are seeing a big upswing in activity."

For Minnesota, the venture capital future hinges on health care and medical devices. In 2003 about 80 percent of the state's total venture capital went to five

firms in the medical devices and equipment category. That focus, experts say, is expected to remain despite Gov. Tim Pawlenty's push toward biotechnology.

Because Minnesota's focus remains on medical devices when it comes to attracting venture capital, Gorman says he does not anticipate a "substantial" change in the

amount of venture capital coming into Minnesota. "I don't anticipate a major move up or down," he said.

Crawford, however, disagrees. He cites companies like Elk River-based Bixby Energy Systems Inc., which is developing technology to replace the country's dependence on mostly foreign fossil fuels, as one way Minnesota's share of the venture capital pot can be expanded.

"They are developing (biomass energy systems) that answer a problem," he said. "When it comes through, it will be a big boost to the state of Minnesota."

Deal flow predictions

Local venture capitalists vary in their predictions about their industry's future.

After being burned in the dot-com frenzy a few years ago, investors are now re-entering the market, becoming interested in medical technology, information technology and health services, Griffith said. Investors' appetites for fast-casual restaurants also have grown because so many meals are being eaten outside the home.

Crawford said he expects venture capital investing in wireless technology to explode. "In the future that is going to be huge in the evolution of communications," he said.

But Knapp said he expects financing to focus on software applications that provide security to business computer systems. In Minnesota, he said, the interest will be in storage technologies and software bolt-on applications.

Gorman said he also believes technology, which has been in the doldrums for the past three years, will enjoy a return in venture capital and M&A activity.

"IT acquirers are now seeing their stock

prices and future prospects brighten," he said. "So, they are more inclined to consider future acquisitions there."

Experience pays

Despite the belief times are changing, local experts in venture capital say they expect startups or early-level companies to still have difficulty attracting investors. But companies with a proven track record — even through the recent tough economic times — will find interested investors.

"Limited partners are open to making new

investments as portfolios open up," said Gorman. "But they are going to focus on groups who have more experience, who have managed their way through a difficult period and have a track record."

Knapp agrees: "I see fewer and fewer funds championing true startups that are generating less revenue and less positive cash flows. But the ice is breaking up."

Sarah Sturmon Dale is based in Chanhassen.



Griffith



Knapp

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