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One Firm's Waltz Across Texas

by Claire Poole

On the surface, Austin Ventures has all the markings of an old-line venture capital firm: paneled walls, Persian rugs, antiques. But this is Austin, Texas, and there's not a necktie in sight, except on a few entrepreneurs nervously pacing the reception area. The receptionist tells them to "hang out" until their meeting downstairs in the conference room.

And in whooshes 34-year-old general partner John Thornton in dark-blue dress shirt and black chinos. "The Daily Deal? Cool," he says after he sits down, picking the paper label off his Osarka water bottle.

Don't let Thornton's youth or casualness fool you. With \$1.6 billion under management, Austin Ventures ranks as the third-largest early-stage venture capital firm in the country, according to the San Francisco-based research firm VentureOne. Half of that booty came last November, when it raised \$825 million for its seventh fund from other venture firms such as Brinson Partners, Crossroads and Pathway, universities such as Harvard, the University of Texas and Dartmouth and the pension funds of General Motors, AT&T and SBC Communications.

"Austin Ventures is one of the most active venture capital firms in the country right now," says Tom Kusner, an analyst at Venture Economics, a research firm in Newark, N.J.

The firm's performance has also been phenomenal—a weighted average return from all of its funds of 70% per year over the past 15 years. It had some especially big hits last year, from Vignette Corp., an Austin-based Internet software firm that went public in February 1999 and recently had a market value of \$13 billion, to MetaSolv Software Inc., a Dallas-area telecommunications software firm that went public last November and recently had a market value of \$4 billion.

With the rise of the Internet and its effect on technology, venture capital has been hot. In 1992, about \$4 billion went into private equity deals, according to Venture Economics. Since then, that figure has mushroomed to a record \$48.4 billion last year, up 151.6% over 1998. The number of firms has also ballooned, from 500 to more than 3,000 last year.

While it's a risky business, venture capital is also a high-return business. According to a recent study by Ibbotson Associates, a Chicago consulting firm, venture capital firms earned an average annual return of 45% between 1960 and 1999—pretty sweet compared to 13.34% for the benchmark Standard & Poor's 500 stock index, 17.16% for small stocks and 7.57% for long-term Treasury bills.

California has long dominated the venture capital scene, with hundreds of companies in the San Francisco area alone. But Austin has surged as something of a "Third Coast" center for private equity deals, with companies in the area raising \$844 million in venture capital investments last year, surpassing bigger cities such as Dallas and Houston. All the activity in

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Austin helped Texas place fourth in PricewaterhouseCoopers' latest ranking of U.S. regions by venture funding.

If you're a high-tech or Internet start-up in the Southwest, the guys at Austin Ventures have become the ones to see. The firm receives between 100 and 200 pitches a week. Last year, it invested in 25 companies and expects to invest in another 25 this year. It currently has active investments in 72 companies.

Austin Ventures' roots are reflected in its investments-78% are in Texas, and 35% are in Austin. And don't come to the firm with an idea for a restaurant chain or a biotech company. The firm's investments center around five areas, or "silos," in Austin Ventures-speak: communications, semiconductors, applications and infrastructure, business-to-business services and e-commerce and business-to-consumer e-commerce and media. Its average investment is anywhere from \$100,000 to \$25 million.

Austin Ventures is not a short-term investor. The company usually stays in a company for five to six years, cashing out either when a company is bought or merges with another company or after an initial public offering-which happens about half the time in today's sizzling new issues market, versus one-third just a few years ago.

"That's pretty cool compared to the Silicon Valley firms, who take a pretty short-term view," says Cliff Sharples, founder and chief executive of Austin-based Garden.com, an Austin Ventures' portfolio company that sells seeds, plants and accessories on the Internet.

Austin Ventures' general partners are active in their portfolio companies, even though their average stake is only about 20%. They help with strategy, hiring and firing and building relationships with other companies. They sometimes even take a board seat.

It hasn't always been a smooth ride. The firm was started in 1982-the year that oil prices toppled to \$10 a barrel and the Texas economy began to crumble. Back then, Austin was better known for its University of Texas, Willie Nelson and state politics. Michael Dell was still a geeky high school kid in Houston. None of the firm's four original partners-Joe Aragona, Ken DiAngelis, Jeff Garvey and Bill Wood-were from the state. But the former bankers and consultants all believed Texas-especially Austin-was ripe for entrepreneurship, particularly around technology.

"We tried to hone the strategy and stick to it," Aragona says. "We raised bigger and bigger funds as the opportunities came."

Austin Ventures started with software companies. Its first big hit was Tivoli Systems Inc., a pioneer in the development of systems software. It ended up being acquired by IBM in March 1996 for approximately \$800 million. It has also been tapping Web companies, from Benefitmall.com, a B2B company in Dallas, to infrastructure companies such as Question.com, All.com and ClearCommerce, which has filed an IPO with the SEC. One of its more recent winners is Austin-based Crossroads Systems, which went public last October at \$18 per share. It's now up to \$123, giving it a market capitalization of \$461 million. And iMark.com, a B2B company in Austin, announced in mid-March that it was being acquired by Pittsburgh-based FreeMarkets Inc. in a \$320 million stock swap.

Over the years though, Austin Ventures has missed some big plays: Austin-based Dell Computer Corp. in the late 1980s (it passed); i2 Technologies, a Dallas-based enterprise software company (the partners couldn't agree with the company's founder, Sanjiv Sidhu, on price); Broadcast.com, a Dallas-based Internet company that went public and was eventually bought by Yahoo! last year (it passed); and Applied Science Fiction, an Austin-based digital technology company that has now filed an IPO (passed).

The partners don't like to dwell on the ones that got away. "You never look at the ones you missed," Aragona says. "There are too many things to do for the ones you've written a check for and you're committed to."

Its timing has also been off at times. Thornton believed 1995 was going to become the year of wireless data, so he invested in a Colorado-based company called Wireless Technology. After several years of losses and not an end in sight, the firm bailed. Now that 2000 is looking to be the year of the wireless data, "I kind of wish we hadn't," Thornton says. "They had one of the most delightful management teams. But it was one of the worst market timing events."

Recent disappointments have come from their investments in e-tailers such as Garden.com and Ashford.com, a Houston-based company that sells luxury items over the Internet. Garden.com went from \$12 at its September IPO to \$24 to a recent \$8.75, and Ashford.com went from \$13 at its September IPO to a high of \$36 to just over \$6. But Thornton still believes in both companies. "It's no fun to be wearing the brown suit with wide lapels," he says. "But fashions come back, and we're committed to both companies."

Semiconductors is one of the sectors where the firm sees the most promise. Austin is already the center of semiconductor manufacturing in North America; it has three \$1 billion fabrication centers, including Samsung, Motorola and Advanced Micro Devices. That means a lot of ideas floating around and a lot of engineers who want to break off to start their own businesses. Austin Ventures is only too happy to help.

Take Silicon Laboratories. The company, which designs, makes and markets mixed-signal integrated circuits, went public Friday on Nasdaq, raising \$84.3 million. Its shares, which priced at \$31, more than doubled within minutes of opening to \$76. The semiconductor industry is also hot with acquisitions. Network processor company Agere was recently acquired by Lucent Technologies, and Benchmark was recently acquired by Texas Instruments. Both of those companies had Austin Ventures as an investor.

Indeed, it has repeatedly invested in some of the same people in different companies. For example, some of the founders of Tivoli left to form Dazel Corp. who later left to form Vignette. "We think of ourselves as less in the deal flow business and more and more in the people flow business," Thornton says.

Austin Ventures encourages its portfolio companies to work together in coming up with solutions and getting to market faster. Some have even joined forces: Witness Motive Communications Inc., which acquired Ventix Systems Inc. last December. Both are based in Austin and are Austin Ventures companies.

Right now, Thornton is leading the firm into the new economy. He's really the only general partner with a Texas connection: His parents came from central Texas, but he grew up in Wichita, Kan. He went to Trinity University in San Antonio, worked as a consultant in the European energy practice of McKinsey & Co. and then got his MBA at Stanford before coming to Austin Ventures in 1990 as a summer associate. He cut his teeth on Tivoli. "For a long time, my partners said I peaked as a summer associate," he jokes.

With Internet and technology firms so hot, there's a lot of competition between venture capital firms for deals. In Austin alone, there are at least seven other venture capital firms. Dallas has many more, its most famous being Sevin Rosen Funds, the original backer behind Compaq Computer Corp. Many of the myriad venture capital firms in California have investments in Austin companies, and some are even opening offices there, including Palo Alto, Calif.-based venture capital firm Garage.com, which just put out its shingle last January.

So how does Austin Ventures compete? "You can't compete just on dollars but all the other intangibles: being part of the people network, understanding the people and the trends, helping the entrepreneur recruit, doing the right thing," Aragona says.

With stiff competition for deals, Austin Ventures has created its own incubator, AV Labs, to invest seed money-usually about \$500,000-in startups that are based simply on an idea, much like Idealabs and Garage.com are doing in California. AV Labs, which has \$60 million to invest, has already helped put together seven companies, mostly centered around Internet infrastructure. Ross Garber, who recently left Vignette as chief executive, is now working as a master entrepreneur there.

"AV Labs is an attempt to cannibalize ourselves rather than let somebody else do it for us," says Thornton, who helped come up with the idea.

Austin Ventures has grown so fast, it's now starting to open satellite offices around the region. Its first two will be in Dallas-one downtown and one along what's known as the "telecom corridor." "We have 22 deals in Dallas right now, and we feel that there's still a lot of opportunity there," Aragona says.

Given the bumpiness of the Nasdaq market in general and technology stocks in particular, some are saying there's a bubble waiting to burst. Thornton agrees that valuations have become dangerously high, but he thinks there are plenty of good companies still ripe for the picking. "It's extremely trite and cliché, but we think if there is a correction, the companies with solid business models are going to ultimately benefit from a more discerning public market," he says.

So what's Austin Ventures' next big deal? If its partners know, they're not talking. "We're in a business of trying to find the next Tivoli, the next Vignette, the next Silicon Labs," Aragona says. "What is it? I don't know; I wouldn't tell anybody if we knew. We'd build it first and then we'd tell people."

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