

A PUBLICATION OF

db dbusiness.com

COVERING THE NEW SOUTH'S NEW ECONOMY

digitalsouth

digitalsouth.com

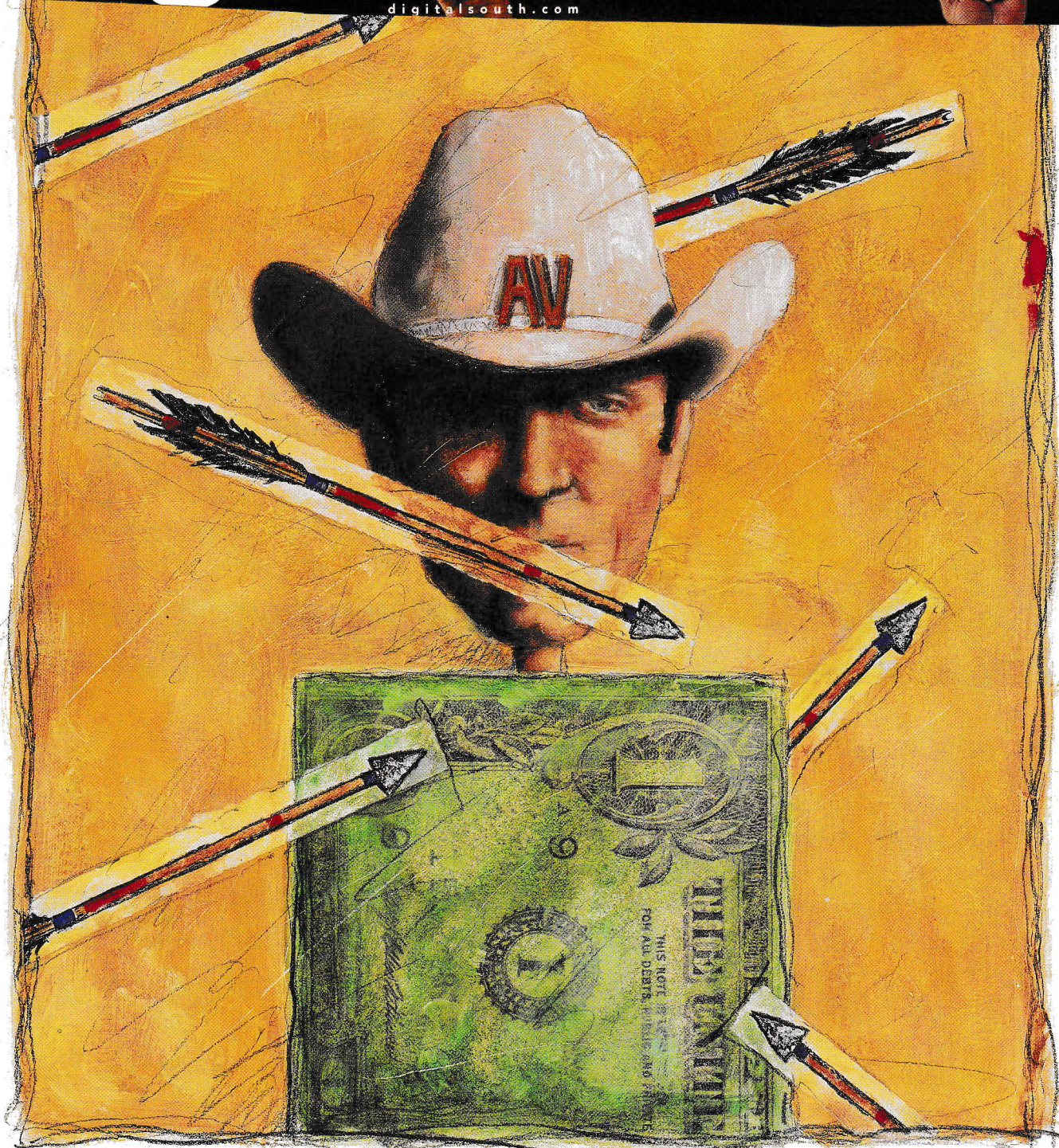


illustration by john rutkowski

AUSTIN VENTURES, THE TOP TEXAS VC,
GETS CAUGHT IN A CROSSFIRE OF BIG RETURNS
AND AMBIVALENCE IN ITS HOMETOWN

LONE STAR



by charles davidson

Joe Aragona doesn't really care what you think.

"The only perception that I care about is [that of] the entrepreneurs and the CEOs that we've backed," says Aragona, one of the two most visible general partners at Austin Ventures, the most visible venture capital firm in the burgeoning high-tech hotbed of Austin, Texas.

"Do I care what the general press thinks about Austin Ventures? I don't care at all. They don't have any influence over my business," Aragona says. "The influence over my business is, 'What does the next great entrepreneur think about when they say, who do I want to partner with?' ... The people he's going to call are the other CEOs we've backed. That's the only reference that counts. Other venture firms say what they want to say. Fine. What we've said — *and I'd like to find public record of anything else*, and who it came from in this firm — is we are a damn good venture firm, and we're a damn good co-investor

with all the other guys who want to practice it in a heads-up way."

Fair enough. But deserved or not, others in Austin's technology community say plenty about Austin Ventures. Much of it is way off the record, for fear of ticking off the city's most powerful high-tech financier. During interviews for this story, nearly a dozen people in Austin's tech community shared unflattering comments or anecdotes about Austin Ventures, but almost none wanted their name attached to them.

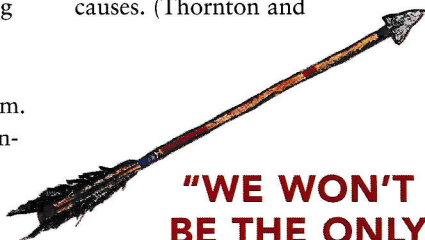
About the only person who openly criticizes the firm is Robert Fabbio, Austin-based managing director of rival TL Ventures, a national VC headquartered in Wayne, Penn. Fabbio was with Austin Ventures for about a year and was a founder of the successful Austin companies Tivoli and Dazel, both backed by Austin Ventures. Fabbio's antipathy toward the firm is well documented around Austin, as he has reacted angrily to Austin Ventures hiring several people away from TL. But when interviewed for this story, Fabbio made it clear he has tired of talking about his rival, whose offices he could almost hit with a paper airplane from his own digs just off Congress Avenue in downtown Austin.

He says the styles of the two firms are "vastly different." "It should be more collaborative," he says. "It's very competitive right now."

When it comes to perceptions of Austin Ventures, a comment from one of its own general partners, John Thornton, is more blunt than most anything anybody outside the firm publicly offers. In explaining that he feels Austin Ventures is unsurpassed at helping Texas tech entrepreneurs build effective management teams, Thornton says: "If you talk to CEOs who've worked with us, you'll hear, 'Those guys may be assholes, but gee, they really helped me build my team.'"

So call Austin Ventures haughty. Call it arrogant and petty, even vengeful. Some people in Austin do.

On the other hand, call Austin Ventures a major force in shaping Austin into a tech center considered the equal of any outside Silicon Valley and Boston. Call it an institution that is playing a growing role in local charitable and civic causes. (Thornton and



**"WE WON'T
BE THE ONLY
REPRESENTATIVE
OF THE SPECIES ANY
MORE, AND THAT'LL
BE JUST FINE"**

—JOHN THORNTON

his wife, Julie, recently donated \$1 million to Ballet Austin.) Finally, call Austin Ventures a venture firm that, like many, has attacked its mission of generating fat financial returns with little concern for subtle niceties.

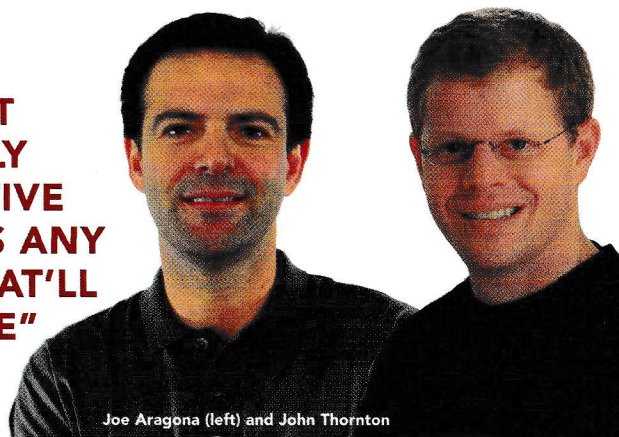
People in Austin call Austin Ventures those things too.

"They can be very difficult. AV has taken the attitude that they own Austin, and no one else should participate unless they turn down the deal," says an Austin venture capitalist who asked that his name not be used. "But they're a great firm and have some wonderful people. And they haven't done anything illegal or unethical. They're just tough businessmen."

Some of the antipathy directed at Austin Ventures is a natural consequence of success, some figure. "They've been very successful, and successful people have a certain air about them," says Mike Dunn, an attorney in Austin with the Silicon

Valley-based firm Brobeck, Phleger & Harrison. "They've had mistakes — as all VCs have — and they've had home runs. I don't find them any different from other VCs. There's a level of arrogance at most of them."

But Austin Ventures is not most venture firms. Ensnconced on the 13th floor of the 71-year-old Norwood Tower, Austin Ventures is the oldest,



Joe Aragona (left) and John Thornton

largest and until the past couple years only substantial venture firm in Austin. Its stately blond-wood paneled offices, decorated like an old-line law firm with paintings of fox hunts and such, are lush but not extravagant. It looks like the home of a sitting champion. Yet, Austin Ventures is more even than that.

As another prominent Austin investor summarizes, yet again with a request of anonymity: "There's no other town in the U.S. that has the dominance of one controlling VC firm like this one."

A magnet for attention

A diminutive man in his mid-30s, the blond-haired Thornton is wiry, intense, animated and clearly highly intelligent. He wears black-framed glasses with narrow rectangular lenses on this day. The corner office Thornton uses seems just-moved-into, with mostly bare walls. His cohort, Aragona, is about a decade

older, tall and trim with dark hair. Twenty years in the Lone Star State have not wiped away a staccato, New York-Italian accent. His corner office is adorned with several golf prints, and various golf trinkets are arrayed on tables and shelves. Conversations with the two men show they are focused on results, and are proud of those the firm has shown.

They seem less comfortable with the reality that, as an integral figure in the city's glamor industry, Austin Ventures is a magnet for attention and scrutiny. For nearly 20 years,

Austin Ventures held great sway over which Austin tech companies received crucial funding, especially from investors outside of Texas. Get Austin Ventures' money, and other investors would jump in. Get rejected by Austin Ventures, and other investors wondered what was wrong.

Austin Ventures differs from most venture firms in another significant respect: It has invested mostly in Austin and Texas. Among venture firms nationally, such a geographic concentration is becoming more common but remains unusual outside

of Silicon Valley. Last year, Austin Ventures invested \$210 million; 56 percent of that, \$117 million, stayed within the 512 area code of Austin. Most of the rest didn't go far, either, as 84 percent, or \$177 million, fed Texas companies. That's been the case for the latter half of the 1990s. Austin Ventures has changed with the times through its 21-year history, doing classic venture deals as well as buyouts in various industries before focusing on information technology in the middle — and late — 1990s.

"They were doing the

deals here when no one else would," says Carol Thompson, a consultant and fixture in the Texas capital's tech community for two decades.

Clearly the leader in Texas, Austin Ventures in certain respects ranks among the nation's biggest VC firms. Consider that 11 venture funds totaling \$1.14 billion were raised in Texas in 1999, according to Venture Economics, an industry research firm. Austin Ventures VII, an \$825 million fund that closed late last year, accounted for 72 percent of the state's total.

Austin Ventures VII, in fact, was the sixth largest pool of venture capital raised in the United States in 1999, Venture Economics says. And Austin Ventures' total capital under management — \$1.6 billion — ranks third among the nation's early-stage VCs, according to Venture One, another industry research outfit. However, Venture Economics ranks Austin Ventures 12th in terms of capital under management, at \$1.5 billion. (VC industry statistics vary notoriously, as different groups use different methods and definitions.)

Aragona, Thornton and everyone else at Austin Ventures say that size, while important, is less significant than performance. But gauging any VC's performance is tricky. Austin Ventures clearly has had some smash hits. The firm's stake in now-pub-

CLEARING THE FENCES

Austin Ventures General Partner Joe Aragona says his business is not for singles hitters. Slugging percentage is what counts, not batting average.

What he means, of course, is that it's important for VCs to crank some monster returns (home runs), as opposed to lots of small ones (singles), from their portfolios.

In that case, Austin Ventures is posting some Mark McGwire-style stats in the first quarter of 2000. First, Silicon Laboratories filed to go public on Jan. 18 in a deal led by Morgan Stanley Dean Witter. IPOs led by Morgan generally do very well. A few of its first-quarter deals: Crayfish Inc., up 250 percent from its IPO price at press time; Palm Inc., up 84 percent; webMethods, up 564 percent; Asiainfo Holdings up 254 percent; and Quantum Effect Devices up 462 percent.

Austin Ventures post-offering owns 10.08 million Silicon Laboratories' shares, which climbed to \$69.38 on the first trading day, March 24. That made Austin Ventures' stake worth \$699 million. The firm invested \$11.3 million in Silicon Labs, which makes specialized semiconductors for cellular phones and other devices.

Second, a day after the Silicon Labs filing, AV agreed to back Lucent Technologies' acquisition of another portfolio company, Agere. And why not? Austin Ventures owned 2.55 million preferred shares of Agere. According to securities filings, Austin Ventures' Agere holdings will be converted to 1.54 million shares of Lucent common stock — worth about \$100 million at press time. Austin Ventures' investment in Agere: \$3 million. AV's rival, TL Ventures, was also a big winner in this deal, as its Agere stake will translate into Lucent shares worth \$140.6 million.

Finally, another Austin Ventures company, ClearCommerce, on March 7 filed to go public and aims to raise about \$57 million. ClearCommerce and its underwriters — led by CS First Boston — had at press time not yet set the share price or number of shares to be offered. But Austin Ventures, for its \$16.5 million investment, owns a whopping 31 percent stake in the company, which makes transaction management software used in electronic commerce. That sort of company, as opposed to online retailers, is still in vogue on Wall Street.

licly traded Vignette is worth more than a billion dollars, after an original investment of under \$10 million. Crossroads Systems is another recent "home run," in VC lexicon. Over the past 15 years, the firm's average annual returns, weighted by fund size, have topped 70 percent, according to Austin Ventures.

In national venture capital circles, Austin Ventures is "very well regarded," says Jesse Reyes, managing director of Venture Economics. Among institutional investors who pour the billions into venture funds, such as university endowments and pension funds, Reyes says Austin Ventures is not viewed as a top 10 VC — those would be mostly Silicon Valley firms such as Kleiner, Perkins, Caufield & Byers and Sequoia Capital — but definitely a top 20 firm.

Austin Ventures has gotten there by placing itself at the center of the "people flow" in Austin, Thornton explains. The firm, by concentrating its business in Austin and Texas, has established and maintained tight relationships with entrepreneurs and executives. Take Vignette for example. As an investor in Dazel, which spun out of Tivoli, Austin Ventures helped to recruit Ross Garber and Neal Weber to Dazel. When they left and formed Vignette, "we were kind of the obvious place to go," Thornton says. "The old joke says, 'the more people you meet, the more you like your old friends.'"

In Austin, there's little question that Austin Ventures has prospered financially.

But locals tend to view the firm in a more comprehensive light. Because of Austin Ventures' long history — long for venture firms, anyway — and pivotal place in Austin's tech community, the firm has achieved a level of renown that is still rare for a venture capital firm between the coasts. Consequently, like the U.S.

president's handling of the economy, the praise and the barbs sent Austin Ventures' way can seem exaggerated. And the arrogant tag can be hard to shake.

"It probably has been more of a

EYES ON TEXAS



AUSTIN VENTURES' INVESTMENTS FOR 1999 TOTALLED \$210 MILLION. JUST OVER 84 PERCENT WAS INVESTED IN TEXAS AND 56 PERCENT IN AUSTIN.

Source: Austin Ventures

challenge for us because for a long time we have been *the* representative of the venture capital species in Austin," says Thornton, who is, along with Aragona, the firm's most high-profile general partner these days.

Today, Austin is a far more mature tech market, and investors have noticed. The city has drawn VCs in droves — some 30 now have local offices. TL Ventures, a major player with \$750 million-plus under management, opened an Austin office in 1998. Other firms arriving in the late 1990s or this year include Divine interVentures of Chicago, Dallas-based Centerpoint Ventures, Sevin

Rosen Funds of Dallas, Houston-based Murphree Venture Partners, and Austin-based Trellis Partners, Sanchez Capital Partners and Triton Venture Management.

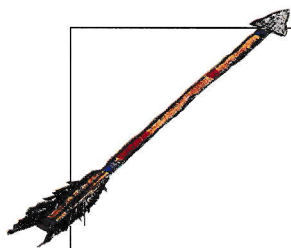
The firms aren't just looking. In 1999, Austin-based companies attracted \$794 million in venture funding, according to the accounting and consulting firm PricewaterhouseCoopers. That's more than triple the figure for 1998, and more venture money than the city attracted in the previous three years total. Plus, Austin in 1999 drew more venture dollars than Houston and Dallas combined, with a population less than a third of either of those cities.

As more money finds its way to Austin, Austin Ventures' dominance wanes, at least by some statistical measures.

Consider that the \$794 million poured into Austin companies last year is more money than Austin Ventures has invested in Texas companies in its entire history. And of the venture funds fed to Austin companies in 1999, Austin Ventures accounted for 15 percent, an out-sized chunk perhaps, but hardly a lion's share. Clearly, then, Austin Ventures is far from the only game in town.

Thornton and his partners have, of course, taken note. While it means more competition — and many believe that is not to Austin Ventures' liking — Thornton and Aragona insist it's not all bad.

"I sort of smile," says Thornton, thoughtful, animated and intense during an hour-long interview, "because the story is, 'There's a lot more money in Austin, so boy those Austin Ventures guys better look out.' That may or may not be true. The good news is, a lot of those same folks are going to have to have the same difficult conversations we've been having for 20 years. We won't be the only representative of the species any more, and that'll be just fine."



AV CULTURE

- **AGGRESSIVE**
- **APPROPRIATE PARANOIA**
- **COMPETITIVE**
- **NOT WIN AT ALL COSTS, JUST WIN**
- **INTEGRITY**
- **INTELLECTUAL HONESTY**
- **AN OBLIGATION TO DISSENT**
- **DEDICATION TO BUILDING GREAT COMPANIES**

Sources: Joe Aragona, John Thornton

Despite the proliferation of the species, Austin Ventures remains the clear frontrunner among VCs in the Texas capital.

Of Austin's nine tech-company initial public offerings in 1999, four were by companies backed by Austin Ventures. Included were smash hits Vignette and Crossroads Systems, whose stock prices at press time in late March had rocketed 1,984 and 516 percent respectively from their IPO prices. Austin Ventures' stakes in those companies were worth a combined \$2.3 billion at press time. The firm invested about \$18 million in the two companies. The \$9 million Austin Ventures pumped into MetaSolv Software, which also went public last year, is now worth about \$500 million. What's more, among the 20-plus liquidity events (IPOs or acquisitions) involving Austin tech companies in 1999 and the first two months of 2000, at least nine were Austin Ventures companies.

All told, eight Austin Ventures portfolio companies went public in 1999. At press time, three — Vignette, Crossroads Systems and MetaSolv Software — had posted substantial gains over their opening prices. Classic Communications was

about even, and three were down. All three laggards — Garden.com, Ashford.com and E-greetings — are consumer e-commerce companies, which have been out of favor on Wall Street as of late.

Austin Ventures' portfolio also includes Agere, acquired by Lucent Technologies for \$420 million in stock at the time of the deal in January; Motive Communications and Hire.com, widely viewed as among Austin's strongest 2000 IPO candidates; and Silicon Laboratories, which filed to go public in January with star investment bank Morgan Stanley Dean Witter as lead underwriter (see sidebar, page 68). Digging into the past, Austin Ventures led the first round of funding of Tivoli Systems Inc., which IBM bought for \$750 million in 1996. Tivoli is widely hailed as one of the foundations of Austin's rise to high-tech prominence. Other prominent Austin Ventures-backed companies include Crystal Semiconductor, VTEL, Dazel and SMART Technologies.

To be sure, Austin Ventures has not funded every great company out of Austin and Texas. Indeed, Dell is just the most visible hit that the firm passed on. Thornton readily ticks off a list of others the firm missed:

Brobeck completed
over 260
public offerings
in the last
three years.

So what?

Dynamic clients
like Crossroads Systems
know why it's important.
Their head-turning IPOs
made waves
from Wall Street
to Silicon Valley.

IN TEXAS CALL US AT

512-477-5495

S. Michael Dunn

ATTORNEYS AT LAW

Brobeck.

When your future
is at stake.SM

▶ www.brobeck.com

AUSTIN • BOULDER • IRVINE • LONDON
LOS ANGELES • NEW YORK • PALO ALTO
SAN DIEGO • SAN FRANCISCO • WASHINGTON, D.C.

Not certified by the Texas Board of
Legal Specialization.

Broadcast.com, Citrix, i2 Technologies and the first round of Hire.com (Austin Ventures invested in its second round).

Just as the Austin technology scene has exploded, so has Austin Ventures. The firm's newest fund — \$50 million of which was channeled into AV Labs, a new vehicle for funding seed-stage companies — is more than double the size of its next biggest fund. That was Fund VI, a \$320 million pool raised in 1998 and drained in just 15 months.

Aragona and Thornton stress that the big fund carries no pressure to invest quickly, or “push money out the door.” It is tempting, he acknowledges. But Aragona cautions that investing in deals simply to get money out is “the simplest and quickest way to go under.”

Investing such a large fund does mean Austin Ventures must expand its ranks of investment professionals, the people who actually find, analyze and vet deals and make investments. The firm hired a half dozen investment professionals early this year, bringing its total to 26, including venture partners who work on deals part time. New hires typically come either from other venture firms, straight out of prestigious business schools such as Harvard and Stanford, from investment banks or technology companies. Those from companies are usually grounded in marketing and business development.

“Trying to find human beings who can get through the gauntlet here and have everybody like you is impossible,” says Thornton. “It’s like we’re trying to elect a pope.”

Complicating things further is that some of Austin Ventures’ old guard is backing away from full-time investing duties. For example, Bill Wood, who joined the firm in 1984 and was instrumental in working with

Motive, is spending much of his time in Australia.

Aragona, who came to Austin Ventures in 1982 from the Bank of Boston, says building an enduring institution is one of Austin Ventures’ fundamental principles. That means regularly infusing the firm with new blood. He points with pride to Thornton and Blaine Wesner, both of whom joined the firm in 1990 and have achieved the firm’s highest rank as general partners.



1. **MERITECH CAPITAL, \$1.1B**
2. **BENCHMARK CAPITAL IV, \$1B**
3. **HORSLEY BRIDGE FUND VI, LP, \$1B**
4. **OAK INVESTMENT PARTNERS, IX, \$1B**
5. **OCTAGON INVESTMENT PARTNERS, II, LLC (CHASE CAPITAL AFFILIATE), \$1B**
6. **AUSTIN VENTURES VII, LP, \$825M**
7. **R.O.C. VENTURE COMPANY LTD., \$650M**
8. **SPECTRUM EQUITY INVESTORS III, LP, \$650M**
9. **ASIA PACIFIC GROWTH FUND III, \$638.9M**
10. **SOFTBANK TECHNOLOGY VENTURES V, \$633.1M**

Source: Venture Economics

While Austin Ventures is evolving, Aragona emphasizes that the core of the firm’s pioneering team is still on hand — Jeff Garvey, Ken DeAngelis, Wood and himself. That team and newer partners have carved out a position in the Austin market that, along with Austin’s glowing reputation, makes Austin Ventures an attractive place for young venture capitalists, Aragona says.

“I don’t want to call it a dominant position, but we’ve got a leadership position here, and people are saying, ‘Hey you guys are expanding, raising a new fund.’ People want to join what they think is the ‘A’ team in a particular marketplace,” he says. “I don’t think it’s the amount of money we’ve raised. I think it’s because of the way we practice the business.”

Scott Harmon likes what he’s seen. The CEO of Motive, Harmon says he has found the firm honest and helpful. Also an executive at Austin Ventures-backed Tivoli, Harmon has worked closely with Wood and Thornton, and says their experience — especially Wood’s having been a venture investor during a recession — has been invaluable at Motive.

“He’s caused us to think about how to position Motive if the economy turns down,” Harmon says of Wood. “I don’t think most companies are thinking about that: What happens to IT spending in a recession? What do CIOs cut and what do they keep?”

That’s music sweeter than anything on “Austin City Limits” to the ears of Aragona and Thornton. In terms of strictly business, Austin Ventures is good. No question. But as much as the firm might like to resist it, it has attained a status that invites judgment based on more than just the bottom line.

That’s where the picture gets fuzzier. 

