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They're Back! VCs Are Looking at the Southeast Once Again

By John C. Yates and Brendan T. McGuire, Special To LTW

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ATLANTA - Venture capitalists are once again looking to invest in technology companies in the Southeast.

After the slowest years in the venture capital industry, VCs are now looking for and making new investments in the technology space. And the Southeast has become an area of interest for VCs all over the country.

The bear market of the last couple of years drove the venture capital industry into hibernation. Since the public markets were closed and capital spending on technology was at a standstill, VCs were forced to make key decisions regarding their portfolio companies. They had to choose which ones would be funded and remain alive, and which businesses would be put out of their misery. Furthermore, they had to invest more cash to keep the "chosen ones" alive until they could start selling product again.

As we moved into 2003, there was still over $85 billion in committed private equity that had not been invested. Limited partners started to wonder why they were paying management fees on capital that wasn't being used. Several funds released LPs of their commitments and cut their management fees. Many larger funds even returned capital to their investors.

The key trends going into 2004 are now apparent:

- **First**, later-stage companies will continue to be very popular VC investment opportunities. Companies that are of interest to the VCs are businesses with real customers that are paying full price for technology products and/or services. VCs have concluded that paying customers are the best way to validate the market for a new technology – rather than making educated guesses based on market analyst reports.

- **Second**, VCs are making larger investments. Since later-stage companies have revenues and are farther along the growth cycle, their valuations are higher. In order to gain the percentage ownership that most VC funds target, these funds must deploy larger amounts of capital to purchase the appropriate amount of stock in these later-stage companies.

- **Third**, expect fewer VC deals to be done in the future. In the current environment, VCs would rather make fewer high quality investments using more capital than spreading small amounts of capital among many businesses. This allows funds to put more of their capital to work while giving them more time to focus on adding value to the investment.

- **Fourth**, the specific areas of interest for VCs have changed. Software and communications have always been very popular among venture investors. In 2003, VCs started to get more excited about biotech, healthcare technologies and services, and business process outsourcing (BPO). Many of the companies in these markets are able to generate profits and cash flow quickly.

- **Fifth**, look for more exotic investments by VCs. Funds that typically make minority investments in early-stage private companies are starting to look at leveraged buyouts, shareholder liquidity deals, private investments in public equities (PIPEs), and other creative transactions.

- **Sixth**, we'll continue to see increased investor attention in the Southeast as a source of dealflow for VCs. This year, many of the private equity investments in Southeastern companies will come from other parts of the country. This is primarily because there are a limited number of venture funds in the region and the average size of those funds is smaller than in the Northeast or West Coast.

- **Seventh**, we're seeing a new approach to VC deal sourcing. VCs are actually building relationships with entrepreneurs and companies. For most VCs, the relationship is more important now than ever. As the dealflow environment becomes more competitive among VCs, investors desire an early "in" to the hotter deals. Consequently, we are seeing VCs meeting with companies very early and with limited initial information. The goal for them is to start a relationship with the company, communicate their value add as an investment partner, and be in the running at the time the company raises money.

So what does this all mean for entrepreneurs in the Southeast?

First, money is still out their looking for a home. If you have a tech company with the right product/service, customers and revenue, VCs have probably already called you.

Second, valuations will continue to improve as VCs start competing for the right deals.

Third, VCs are a lot more accessible than in years past. They want to build relationships and know about your company. And finally, if you are in the Southeast, your chances of attracting investors from DC, Boston, NY and even the West Coast will continue to increase. Overall, the technology venture capital scene has become more competitive – a factor that should bode well for entrepreneurs in 2004.

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