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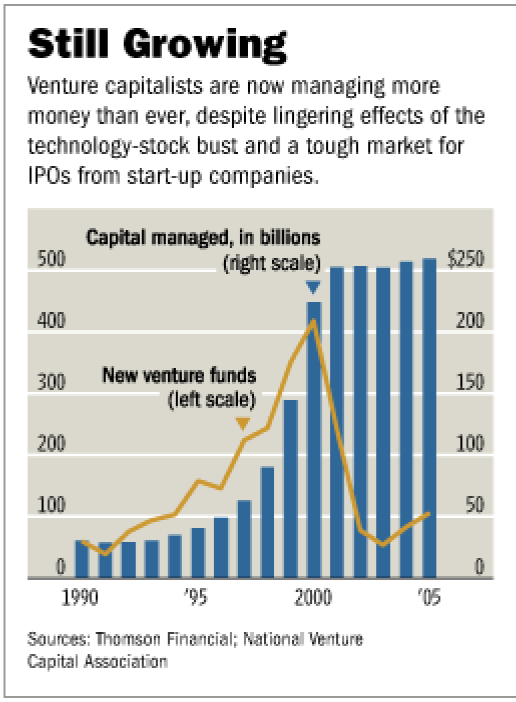

Tech Bust's Last Chapter Plays Out at VC Firms

Mobius, a '90s Star, Pulls Back, And Others Could Follow Suit, As Losses Take Years to Be Tallied

By REBECCA BUCKMAN
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SAN FRANCISCO -- During the dot-com boom, Mobius Venture Capital belonged to Silicon Valley's billion-dollar club: highflying investment firms that raised $1 billion or more to plow into hot start-up companies, many of them Internet-based.

Mobius learned that bigger wasn't necessarily better. As technology stocks tanked, the firm wrote off failed Internet and telecom investments. It cut a planned $1.5 billion venture fund to $1.25 billion. Its biggest backer, Japan's Softbank Corp., pulled back from the U.S. market after losing millions on flops like Internet grocer Webvan Group. Several partners -- including founder Gary Rieschel -- later left the firm.

Now Mobius is pulling back even more, a scenario some expect to be repeated across Silicon Valley.

Mobius has no plans to raise a new fund with its existing investment team, and its staff is scattering. Some senior members have moved far from the center of the venture-capital world in Silicon Valley to Colorado. There, people familiar with the matter say, they may join managing director Brad Feld in breaking off from Mobius to form a new fund. Mr. Feld wouldn't comment on his plans. He confirmed in an email that Mobius's current team isn't raising more money, but said the firm would keep backing companies in its existing portfolio. Three Mobius managing directors -- essentially partners -- left in Silicon Valley have decamped to smaller offices, and some could move on to other jobs, people familiar with the matter say.

Silicon Valley is the center of an industry that research provider VentureOne says raised 24 funds of $1 billion or more in the boom years of 1999 to 2001. Some large funds haven't parlayed recent investments into lots of big hits and may face the music and wind down operations. Like Mobius, a few venture firms have made the painful decision not to raise new funds.

"There's definitely some fallout," says Mike Hirshland, a partner with Polaris Venture Partners in Waltham, Mass. "There are a lot of funds ... that won't get funded again." Polaris announced a new $1 billion fund in February, which it says is part of a "diversified" strategy to target life-science deals, as well as technology. The fund also will invest in private-equity deals, which can be less risky, but typically require more cash to buy stakes in larger, more mature companies.

The $260 billion venture industry didn't contract much after the tech-stock bust, and many academics and investors say it should get smaller -- though the global glut of cash among big institutional investors probably will keep many venture funds afloat for a while. "New funds will displace those who leave," says William Sahlman, a professor at Harvard Business School specializing in entrepreneurial finance.

Most venture funds invest over at least 10 years, meaning it can take a decade to figure out if a fund is going to make money. Venture capitalists who raised huge funds in 1999 or 2000 now are beginning to get an idea of their returns. For many, it isn't a happy picture: The average venture fund raised in those two years so far is losing money, according to research firm Cambridge Associates.

Mobius investors say both its $630 million fund raised in 1999 and its $1.25 billion fund from 2000 are well underwater. With a few promising investments, including stakes in personal-gadget maker **Danger** Inc. and optical-networking firm Infinera Inc., the more recent fund may ultimately become profitable. Mobius founder Mr. Rieschel, now a managing director with Qiming Venture Partners in Shanghai, predicts that the fund ultimately will return "significant" profits.

He acknowledges he and his partners invested too aggressively in too many risky start-ups after the firm realized some quick gains during the Internet boom. But he says his departure -- not the firm's performance -- is the main reason Mobius isn't raising another fund.

Partner turnover, which plagues many firms with poor returns, can be a turnoff to savvy investors in venture funds, such as university endowments. They often prefer established teams with a history of working together. And with Wall Street still wary of small-company, initial public offerings of stock, returns are under pressure across the board. Venture capitalists make money only when companies they back go public or are sold to larger firms.

Worldview Technology Partners, a Palo Alto firm that has lost key staff over the past few years, in late July told investors it was canceling efforts to raise a fifth fund of $250 million, at least for now. Semiconductor-design firm **Cadence Design Systems** Inc. is shutting down its venture arm, Telos Venture Partners, according to regulatory filings.

Meanwhile, some firms are shifting focus and raising huge funds, partly to invest larger chunks of money in bigger companies and reduce their exposure to traditional higher-risk venture capital.

Mobius had a string of investment successes in the mid-to-late 1990s, when the firm, then known as Softbank Venture Capital, was led by Mr. Rieschel and Charles Lax, who left in 1999. The hits included computer-security firm VeriSign Inc.; home-page site GeoCities Inc., which was bought by Yahoo Inc.; and software maker Art Technology Group Inc. Mobius added staff and raised larger funds.

After the tech bust in 2000, Mobius stumbled with investments such as Terabeam Corp., a wireless firm in which it invested more than $80 million. Mobius wrote off much of that after Terabeam didn't live up to its promise. Mobius lost other staff, including managing directors Bill Burnham and Carl Rosendahl.

In April 2005, Mr. Rieschel agreed he would leave the firm. He and his Hong Kong-born wife and their children had been living in China for several months, so he could pursue his longtime goal of investing in Asian companies. Mobius had talked to big investors in late 2004 about raising a fund to invest in Chinese, Indian and U.S. companies. Potential investors said that "you're either a China fund or a U.S. fund" and didn't support the idea, Mr. Rieschel says.

When Mr. Rieschel struck out on his own, "the writing was on the wall" that Mobius might not move forward, says Mr. Lax, who is now with GrandBanks Capital. Mobius partners are "devoted, focused people" who are now trying hard to return money to their investors, he adds. "But ... they raised too large a fund, they committed the capital as if there was no tomorrow, and they dug holes like Terabeam that were insurmountable."

Write to Rebecca Buckman at rebecca.buckman@wsj.com[1]

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