

Venture Firms Locate Telecom Bargains

By Lisa Bransten

Staff Reporter of The Wall Street Journal

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After a long dry spell, venture capitalists seem to be buying up pieces of telecommunications-equipment companies again, though mostly from the bargain bins. Chiaro Networks Ltd., for example, is set to announce today that it has raised \$80 million from existing investors and some new investors. Innovance Networks has raised \$55 million mostly from existing investors. Meanwhile Caspian Networks Inc., is closing in on more than \$100 million in a fourth round of financing, according to people familiar with the deal.

But raising that kind of money these days is no picnic. Caspian, based in San Jose, Calif., wouldn't comment on its valuation, but people say the company, which once was valued at as high as \$450 million, lowered its value to as little as \$5 million in order to raise the new cash. Meanwhile, executives from Chiaro, of Richardson, Texas, and Innovance, based in Ottawa, say they also had to lower their valuations in order to bring in the new money. Though neither company would be specific, executives at Chiaro and Innovance said they didn't cut their valuation as drastically. And they are the lucky ones. Scores of telecom-equipment companies have gone out of business, and experts anticipate many more to do so during the year. About 1,966 telecom-equipment companies were started between 1997 and 1999, according to Newark, N.J., venture-research firm Venture Economics and many will need to raise new money this year. Raising money is tough because values of public telecom-equipment companies are depressed and network operators, who are the customers of most of these companies, have drastically cut their budgets for new equipment. Even so, there is still a good deal of opportunity in the sector says David Ladd, a general partner at Menlo Park, Calif., venture firm Mayfield. Ultimately, the carriers will start buying again, he says: "If you can get enough money and keep the burn rate reasonable and hang on for two years then you have a good shot at being there when the service-provider market starts buying innovative product." Late last year, Mayfield participated in a \$60 million round for equipment maker White Rock Networks, in which it had already invested. But the firm also has shut down some companies whose burn rate they deemed too high to continue to carry until they could start selling product. Because equipment companies are so cash hungry the risk is all in the timing, Mr. Ladd says. "If you're off [about when the market comes back] and you run out of money, then can you raise more and at what valuation?" Peter Allen, founder and chairman of Innovance, expects buyers for the optical networking systems his company is developing to come back in the second half of this year. He adds that the new money should be enough to get him through the middle of next year and, depending on market conditions, maybe to the point where the company is generating cash. As is the case with many financings these days, much of the new money came from existing investors, with Advanced Technology Ventures of Palo Alto, Calif., making the biggest contribution to the round. Other investors include JDS Uniphase Corp., Corning Inc., Morganthaler, Thomal Weisel Capital Partners and Azure Capital. Chiaro managed to raise new money from outside investors, but the company, which was founded in Israel and still has operations there, turned mostly to Israeli firms Delta Ventures and Poalim Capital Markets for the new money. Existing investors including CenterPoint Ventures, InterWest Partners and Sevin Rosen Funds also put in more funds. Chiaro is developing a sophisticated router that guides traffic around the core of the Internet and should start trials next quarter. Chief Executive Ken Lewis says the value that investors placed on the company is down from the \$400 million valuation it got in September of 2000 when it raised \$100 million, but is "still reasonable." It should be the last money the company needs to get to break-even. Last time around, Mr. Lewis joked that venture capitalists who funded the company sought less information than did his bank when he applied for a corporate credit card. This time it took the VCs six months to complete their due diligence. "In the year 2000 you put your hat out and investors gave you money," he laughs. "You put your hat out today and if you're not careful you'll lose your hat."