RED HERRING

Great Expectations

G&H co-founders Terry Garnett (left) and David Helfrich (center) flanked by John Kish, CEO of Wyse Technology, the firm's first buyout.

After completing just one deal, veteran VCs Terry Garnett and David Helfrich's young venture buyout firm is the buzz of Silicon Valley. How will they live up to the hype?

Right now, the phone at Garnett & Helfrich's office on Sand Hill Road is ringing off the hook, with dozens of senior managers clamoring to be chief executive of the next G&H company.

"I'm a senior executive at company X," they tell Terry Garnett, whose boyish looks and Dennis-the-Menace blonde hair belie what his partner calls a "maniacal" devotion to his companies. "I'd love to get a chance to run a $100-million business for you," they say. "I've been approached to run startups, but I could never get excited about managing a 20-person firm just trying to get a product out."

A lot of other calls are coming in to Mr. Garnett and co-founder David Helfrich, whose lanky frame recalls a more youthful, less dour John Kerry. From billion-dollar public company division heads angling for a G&H buyout; from buyout shops like Francisco Partners referring deals too small for their firms; and, very often, from John Kish, G&H's former CEO-in-residence, now chief executive of G&H's first investment, Wyse Technology, a thin-client network-centric computing company.

One year after closing a $250-million inaugural fund, Mr. Garnett and Mr. Helfrich already possess the confidence and dealflow access of an established firm. Yet they've made only one investment, and the entire fund's returns will rest on just five deals. While G&H's investment thesis has changed slightly, its success still depends on the deals and executives they choose.

The firm's focus is the largely untapped venture buyout market: purchasing business units from large companies and growing them into billion-dollar businesses.

While these deals are generally too small for private-equity giants like Texas Pacific Group, they're sometimes scooped up by smaller private-equity firms such as Vector Capital and large venture firms like Oak Investment Partners. Venture buyouts aren't tracked directly by research firms, but there's no doubt their aggregate was a tiny slice of the $53 billion spent on buyouts last year.

Mr. Garnett wants to dominate that slice, and expand it. He counts about 175 technology companies worldwide with more than $5 billion in revenue, each with a dozen potentially G&H-able units. Even if one in 10 is a lucrative deal, with so little competition, it seems like finding hay in a haystack.

Separating the Deals from the Dogs

G&H targets business divisions with massive, unrealized upside potential. They might be buried inside a holding company, like Wyse, waiting for a cash infusion toward a worldwide sales and marketing expansion, or perhaps they're making millions selling technology totally disparate from the parent company's core business.

It takes a unique combination of skills to avoid the dogs and spot divisions with billion-dollar potential—a buyout firm's ability to discover a diamond in the rough and a venture firm's vision to realize its promise.

"It's a hybrid between being able to evaluate something as a good investment, and having been out in the trenches building products and partnering," says Mr. Garnett, who was a senior executive at Oracle in the early 1990s before unearthing lucrative early-stage deals—including Siebel Systems and Checkpoint Software—as an angel investor and at Venrock Associates. Mr. Helfrich co-founded or joined early at four billion-dollar networking companies, then co-founded ComVentures, where he invested in Kagoor and P-Cube, which were recently bought by Juniper and Cisco, respectively.

Those successes have given the duo the confidence to be aggressive in their dealmaking, Sand Hill Road conventional wisdom be damned.

"Whenever I started companies, people said I was crazy and I'd never succeed, that I was smoking something," says Mr. Helfrich. "It got to the point where if I didn't get that response, I got nervous."

It's easy to be confident, though, after grilling a startup's founders about their company's finances. When putting together a buyout offer, G&H rarely has access to all of a company's data. For instance, Wyse was privately owned by the Koos family's holding company in Taiwan, although it had previously been public.

"It's very hard to figure the numbers out before you go in," says Mr. Garnett.

Often, G&H's assessment is driven by the target's customers. Before they made an offer for Wyse, Mr. Garnett and Mr. Helfrich traveled around the world talking to its clients, including Sears and Deutsche Bank.

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DAVID HELFRICH,
CO-FOUNDER,
GARNETT & HELFRICH

"The most important asset we're acquiring, even beyond the technology, is the value of the customer base," says Mr. Garnett. "Care and feeding of that customer base is a big priority."

The Venture Startup

When Mr. Garnett first pitched the idea of a venture buyout firm to Mr. Helfrich over breakfast in early 2003, he already had one test case. Mr. Garnett and Robert Theis of Doll Capital Management had bought PGP, Network Associates' messaging security unit, on the cheap.

After a sleepless night obsessing over the proposal, Mr. Helfrich called Mr. Garnett and said he was ready to explore it. By fall 2003, fund-of-funds Grove Street Advisors and the Harvard endowment had committed. G&H announced the fund's close the following April.

Mr. Garnett and Mr. Helfrich originally expected to spin off about nine companies with $20 million to $100 million in revenue, but soon decided that the best deals were on the high end of that scale, and often larger. "We've looked at a couple of situations where the entity has $30 million in revenue, and it just feels too fragile," says Mr. Garnett.

Wyse was profitable on 2004 revenues of $200 million when G&H invested $35 million for a 50 percent stake, with the Koos family adding some debt to value the company at $150 million. With the larger deal size, G&H will fund less than half a dozen startups, increasing the pressure on each deal and the importance of the executives running them.

Managing and growing a bought-out business requires distinctive skills, so Mr. Garnett and Mr. Helfrich have narrowed the CEO candidates down to a very short list.

"This is not something they teach in business school, or even attempt to," says Mr. Helfrich. "You can't efficiently communicate how to do this. Some people are better-suited, but you have to spend time in the trenches to learn."

Before he even had a deal in mind, Mr. Garnett had pulled Mr. Kish, a former senior executive at Oracle and four-time CEO, out of retirement to become G&H's CEO-in-residence. Mr. Kish joined the firm's founders in exploring several potential buyouts before settling on Wyse.

When G&H first met with the Koos Group, Mr. Kish was there. He and a shadow executive team had already spent months analyzing Wyse. They prepared full-time for the transition for three more months before Mr. Kish became chief executive, and the deal closed early this year.

Several VCs, including August Capital, which saw success with the Seagate buyout, are considering an expanded focus on buyouts in their new funds. If G&H gets some large exits, more VCs may soon follow it into the market.

"It's temping for venture people who are struggling to take a shotgun approach, throw stuff at the wall," says Mr. Helfrich. "But if the space gets too crowded, Terry and I will figure out what the next thing is." RH