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VCs offer light at end of tunnel

Firm eager to invest in underperformers

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Eric Rothfus (left) and Michael Falcon run Guggenheim's Austin office.

A local venture capital firm is looking for trouble.

In addition to conventional venture capital investments, Guggenheim Venture Partners, which opened in Austin two years ago, is specializing in distressed-company deals. As a type of Dirty Harry of Austin's VC community, Guggenheim is investing in businesses that haven't provided returns to previous investors.

Since Guggenheim's Austin practice started investing in October 2008, the Pennsylvania-headquartered firm has backed three local companies. Equiphon Inc. and Conformity Inc. were two conventional VC deals.

But the Bandspeed Inc. investment recently is a restart of a company that had already collected more than $50 million from eight VC firms during its first 10 years, CEO William Eversole said.

Bandspeed, which develops tech products such as a radio frequency analyzer, has never provided returns to its investors because the market had not yet developed for its products, he said.

But Eversole expects Guggenheim's investment and advice to change that.

"It helps right the ship and get you back on track," Eversole said. "We went through that process through the Guggenheim guys. We're a lot smarter now that we're bringing in capital and [ensuring that the money is spent wisely.]"

Last month, Bandspeed reported raising $4.5 million of a planned $9.5 million round of financing. Guggenheim kicked in $2 million. Five investors participated in the funding, according to the U.S. Securities and Exchange Commission.

Bandspeed's ability to collect capital runs counter to trends. By midyear, investments in local VC-backed companies declined nearly 60 percent to $172 million compared with $419.4 million during the first six months of 2008, according to Dow Jones VentureSource.

Experts said the landscape for startups seeking initial VC investments is even drier because firms are preserving capital so they can see their portfolio companies through the recession.

Guggenheim Venture Partners — a division of Guggenheim Partners LLC, a financial services firm with offices in Chicago and New York — closed in February its first fund, which reached $65 million, Austin-based managing director Eric Rothfus said.

In February, it completed a $3 million Series A round of financing of Conformity, a developer of a software-as-a-service product that manages multiple software-as-a-service products at one time. As part of the investment, Rothfus joined Conformity's board of directors.

Guggenheim's investors are former electrical engineers, so the firm's natural focus is on technology businesses, such as semiconductors, rather than health care or financial services software, he said.

The distressed company speciality was sparked by the large amount of what Rothfus calls "stranded capital" — money invested in companies that can't complete a liquidity event, such as an initial public offering or an acquisition. That means the investors can't exit the deal and pay off the limited partners who invested in their funds.

Such scenarios often place the immediate needs of investors in conflict with long-term needs of the portfolio company.

But with a change in strategy combined with giving up some ownership and Guggenheim's venture capital, distressed companies can get out of limbo and provide investors with returns that would enable their firms to raise subsequent funds, Rothfus said.

"There are situations where investors and companies are at odds with each other and the management team is stuck in the middle," he said. "Our goal is to find those companies."