

Start-Ups Top Off Tank Instead Of Refuel

by Scott Denne

Since the beginning of the year, Symplified Inc. has fielded calls from venture capital firms inquiring about investing in the company. After raising a \$6 million Series A round in October 2007, Symplified launched its Web access-management products in June and has seen sales rise faster than it expected. It's also received sales calls from large corporations, something that Chief Executive Eric Olden says he didn't expect for another two years or so.

These factors might make it an opportune time for Symplified to begin raising a Series B funding round at a higher valuation. But these days, with the economy in a tailspin, the valuation that comes with a new round is likely to be even with or lower than the previous one, even for start-ups hitting their milestones or surpassing them.

So instead of raising a Series B round, Symplified hopes to bring in outside investors for an extension to its year-and-a-half-old Series A round at a flat valuation. This is what some investors are calling a "top-off" round. Unlike during the tech bust earlier in the decade when investors would put a little bit of extra previous-round cash into troubled portfolio companies to keep them alive, these top-off rounds involve growing start-ups that attract new investors to the syndicate.

After the collapse of Lehman Brothers Holdings Inc. in September knocked the financial markets out of whack, some promising venture-backed companies have raised these top-off rounds to survive the downturn. These start-ups are seeking to maintain the momentum and interest from the previous round, and in the process, extend the time between the last round and when a new valuation will be necessary.

In November, Palo Alto Networks Inc. decided to go back to investors who had shown interest in its \$27 million Series C round, adding another \$10 million from Jafco Ventures, Japan Asia Investment Company and Northgate Capital. The company was able to grow its customer count by 25% to 100 in the two months between the two closes. More recently, Aster Data Systems Inc. added \$5 million from Institutional Venture Partners, which desired to lead the original \$12 million Series B, but was beat out by Jafco Ventures.

"The uncertainty in the macro economic environment is leading companies to raised more capital, rather than less," said Steve Harrick, a general partner with Institutional Venture Partners. "When the venture business is done properly, companies raise rounds to get to milestones, but now they're not sure customers will let them get to those milestones."

These top-off financings allow investors to continue putting money to work, and they don't usually have to spend time negotiating terms and preferences because they can piggyback on the due diligence from the last financing.

Pete Bodine, a managing director for Allegis Capital, estimates that 80% of the deals that the firm is actively looking at involve topping off the last round. For the past several months, Bodine said he has received calls from other investors to gage his interest in participating in such rounds, and recently the quality of companies is increasing. "Last year, it was stuck or marginal companies, but now it's companies that are on plan or ahead," he said. "It's taken an extra two months of bad news, but now entrepreneurs are of the mindset that surviving is winning."

Still, many venture capitalists express little interest in participating in these types of deals as outside investors. They say they would be giving away too much by agreeing to put in new money under pre-recession terms. Valuations can often be negotiated downward, even with competition from other firms, they say.

"There's always the success stories, but if you grab 100 random companies, you're seeing most [who have brought in new investors] getting valuations that they are not happy with," said Mike Conza, a partner with law firm Bingham McCutchen LLP.

In taking in a few million in additional Series A financing, Symplified hopes to postpone its Series B round until after the recession and extend the runway to "outlive and outlast" the competition, Olden said.