



ALLEGIS CAPITAL QUARTERLY

Corporate Partnerships: Correcting the Impedance Mismatch

By Robert R. Ackerman Jr., Managing Director

IN OUR LAST NEWSLETTER WE TALKED ABOUT the need for partnerships between large corporations and entrepreneurial companies. Large companies, hampered by bureaucracy and vested interests, rarely recognize a disruptive technology as it creeps up on them. Working with startup companies will become, out of necessity, a core competence of large corporations.

While change is a necessary evil for large companies, it is simply a necessity for entrepreneurial companies. But entrepreneurs often find themselves without sufficient time or resources to expand quickly enough in a global marketplace to keep competitors from moving in on their markets. The right partnerships can combine the strengths of both types of organizations to their mutual benefit.

While that may be intellectually obvious, it is not easily done. There is always an opportunity for misunderstanding between any two business partners. But there is also an enormous impedance mismatch between the deliberate, thoughtful approach to decision-making of big companies and the lightspeed pace of entrepreneurs. Entrepreneurs want to bring about a disruptive technology as rapidly as possible, while large corporations would prefer an orderly change, on their terms. Both organizations must change their DNA to allow them not only to coexist, but almost to virtually mate.

Creating partnerships is an issue we have worked on for many years at Allegis Capital; it is our true core competency. Silicon Valley is a notoriously insular community, and it can be hard for a large corporation to penetrate that society and identify the good opportunities. We work closely with the corporations who have become our limited partners, and understand their business. We are part of the ecosystem of Silicon Valley as a seed and early stage investor, and see new opportunities before large companies are aware they exist. But entrepreneurs are preoccupied with the 12 things they need to do today, with time to only do eight of them. They don't have the time to do the research to find a good partner and set up the relationship.

In this issue, we will share the techniques we use as a matchmaker between our entrepreneurs and corporate partners who invest in our funds.

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Timing. The first key is timing. Technology development is driven by the vision of entrepreneurs and their zeal to execute. This is not the point where a large corporation adds a lot of value. In the early development stage, the young company is likely to see the older one as a threat. A large company will want to shape the tool under development; it wants you to build their hammer, not yours. By and large, the entrepreneur has enough understanding of the product and the market to drive through that process on its own.

Once the entrepreneurial company has gotten to the alpha or beta testing stage, then it is on the cusp of being able to create a winning relationship with a large company. After it can show them the validation of the product, then the large company can help with market positioning and fit and finish by offering its domain expertise and taking the product before its customer base.

Finding a Partner. It is crucial to find the right partner. Not every corporation has the skills and personalities in top management to work with a small partner. That is where a good mediator can help (and is a big part of the reason we formed Allegis Capital). Every venture firm has a long list of corporations in their Rolodex, with five

names to contact at a particular company. But that quickly becomes a rat hole that swallows up time and resources.

We look for investments from the start with corporate partners who can have a positive impact on a small company, not an overwhelming one, and who can have these discussions at a senior level. If the corporations do not have the personality to be good partners, then a partnership will end up being more work than it is worth. We have rejected investments from corporations who have a history of destroying small partners.

Entrepreneurs Come First. A partnership must always be formed on terms driven by the entrepreneurs. Rules number one, two and three at Allegis are, “Do no harm to the entrepreneurial companies.” The entrepreneurs decide what information to share. If we introduce them to a potential partner, but the entrepreneurs decide they want to work with another they feel is a better fit, they must be allowed to walk away from the deal.

History has shown that, nearly every time a large company and a small one are in direct competition with each other, whenever David faces Goliath, David wins. That entrepreneurial ability



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to overcome great odds must not be destroyed by having David form an alliance with Goliath. The large company must not pollute the environment of the entrepreneurial company.

One of the things we take pride in at Allegis is that we’ve all walked in the entrepreneur’s shoes. We’ve already bet on the entrepreneurs in our portfolio, and we’re not going to try to convince them to do a bad deal.

Trust. Any relationship starts and ends with trust. Trust is not easy to come by, and is not established over a singular event, like getting financing from a large corporation. Management at both companies need to get to know each other, and must respect each other in order to develop trust. If you cannot take the time to develop it, it is better not to form a partnership.

For that reason, it is often best to enter into a relationship in stages. By developing a relationship through small steps, the two companies have time to get to know each other and develop a true relationship based on compatibility and mutual interests. This is the kind of information that cannot be sorted out once the companies are trying to work out a major deal with each other.

Rent, Lease Or Own? The depth of a relationship must be predicated on the level of benefit each company will receive. Is this a tactical or strategic relationship? Does the startup have a product that is a good addition to the large company’s product lineup, or does it have disruptive technology that’s core to the large company’s interests? There is a correlation between volatility and the value an entrepreneurial company can offer.

The decision on what kind of relationship to develop is analogous to a decision of whether to rent, lease or own. If a startup’s product appears

at first to be a simple extension of a large company’s product lineup, perhaps the best relationship is to rent, to create an arm’s length relationship that can be ended at any time. In this case, the large company might become a distributor of the new product.

If the product or technology turns out to be part of an important product thrust for the large company, then a lease may be in order. The large company may create a long-term relationship by, for example, providing some funding in return for a piece of equity.

The penultimate issue is when the innovation from the small company is core to where the large company is taking its business. In that case, the relationship may best evolve into an acquisition.

If you can create a successful relationship, build trust over a period of time, and develop an understanding of what value each party can bring to the table, you end up with a shared vision of the opportunities available from working together. This is a wonderful way to forge a path to success. ■

Venture Capital Update

“We all thought,” as the excuse goes, the Google IPO would re-open a festive IPO season. Then, “we all thought” the same Google IPO was destined to, if not failure, mediocrity. Look, they had to lower their estimated price from \$135 to \$85. Today it stands at \$172, the same day the Dow slides to a low for the year, more than 100% above the controversial IPO’s price.

All the while, the appetite of large companies for small ones continues unabated. For example, in September 2004, Cisco bought Dynamicsoft, a SIP (Session Initiation Protocol) company providing carrier-class solutions. Dynamicsoft was a venture-backed company. Yahoo! acquired MusicMatch, Oddpost and Bloomba, two e-mail related companies. Mailblocks, started by the late Phil Goldman, was acquired by AOL. Google acquires Pyra Labs, Applied Semantics, Sprinks, Neotonic and Picasa. No need to continue. Barring the Google teaching moment, we don’t know what we’re learning yet, venture investors can’t count on the IPO exit, but the M&A route is well-frequented.

IronPort, see the story two newsletters ago, is getting kudos for its real-time Virus defense. VOF, standing for Virus Outbreak Filter, allows IT organizations to shoot down virus attacks in as little as 15 minutes, without waiting for updates from anti-virus suppliers.

See <http://www.informationweek.com/story/showArticle.jhtml?articleID=4880008> and dozen of others. Try VOF + IronPort in Google, there were more than 300 hits as of this writing. ■

New Managing Director Joins Allegis Capital

Spencer Tall, formerly co-founder and General Partner of APV Technology Partners, managing three funds over a period of 10 years joined Allegis Capital in October 2004 as a Managing Director of the firm. Mr. Tall is a co-founder of Asia Pacific Ventures, LLC, a consulting and advisory services firm where over a thirteen year period he assisted more than 50 technology companies in their Asia expansion plans. Mr. Tall’s prior investments include E.piphany, Web TV (acquired by MSFT), One Touch Systems (acquired by Hughes Satellite), Netcell Corporation, Locality (acquired by e2Grow), and North Systems. ■

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Putting the Media in Media Technology Ventures

By Jean-Louis Gassée, General Partner

MEDIA TECHNOLOGY VENTURES. In 1999, that's what we started calling our new funds. We're now at MTV III and IV. The idea? Digital media were destined to pervade every aspect, every hour of our lives.

Being digital was the future as one of the noted seers, Nicholas Negroponte, founder of MIT's Media Lab, observed in his 1996 book called, you guessed it, *Being Digital*. The author made the semi-correct observation we were moving from exchanging atoms to exchanging bits. He once described his astonishment at having to drink Evian (French atoms!) in California. This happened at a conference on protecting the competitiveness of America's computer and electronics industry. Negroponte said the slow physical movement of digitally recorded music stored on plastic and wrapped in expensive cardboard had to be replaced by "the instantaneous and inexpensive transfer of electronic data." Music industry executives probably failed to read, or understand, or do anything to get ahead of the movement, perhaps drowning in the toxic waste of their fat profits. McKinsey consultants diplomatically call this the "incumbent's curse."

Not many books on the future of digital technology are worth reading past their sell-by date, two years at best, but this one is a good read *eight* years after its publication. Negroponte even provides a useful, practical discussion of a much-abused term, exponential. (Ironically, an Amazon search of the contents of the book reports ZERO instances of the term MP3 in *Being Digital*, even though the MP3 technology was patented in 1989.) Even the best of seers can't see everything.

So, penetrated by the obvious and blessed by a higher authority, Media Technology Ventures it was. And in an apparent paradox, we've

invested mostly in enterprise software, silicon, networking, e-commerce or wireless applications media technologies. We believe this is about to change, we see the lofty projections becoming pedestrian, bankable reality.

Speaking of projections, as Negroponte observes in his explanation of "exponential," apparently innocuous differences in the set-up of an "exponential" growth curve (a geometric progression, really) can make a big difference in the outcomes. Please trust the math: it doesn't take long for a 50% error, half too little, in the estimated growth rate to cause a more than 500%, five times, error in the projected outcome. Contrast this with a linear progression in which a 50% error at the beginning "only" creates a stable 50% error forever.

By the same token, it's easy to experience another surprise. If the "exponential" growth rate is small enough, it is easy, in the early days of the phenomenon, to mistake slow geometric growth for boring linear, additive growth and then see an "explosion" after awhile.

Back to earth, the "everything-on-it" media center hasn't happened but many believe real growth, meaning real dollars, is about to happen. Conversely, who thought every (almost) new cell phone would sport a camera? 3G networks haven't appeared, but threaten to do so, but there are now DSL connections offering TV programs and you no longer have to live in Korea or Japan to be offered 6 megabits/second connections (clocked at 3.3 Mbits/s in a recent consumer test). But the most visible, or most talked about of these phenomena is, of course, on-line music distribution (legal or not) and the stunning success of the iPod—2 million units sold last quarter.

I shouldn't forget satellite radio and the augmentation of GPS navigation thanks to traffic

information coming from the sky. Or the fact most TV content is transported digitally, even if it has to be converted back to analog and looks worse than the original on most existing TV sets.

In other words, the digital media technology predictions made years ago finally do come to pass, some of them materializing sooner than expected, some of them differently.

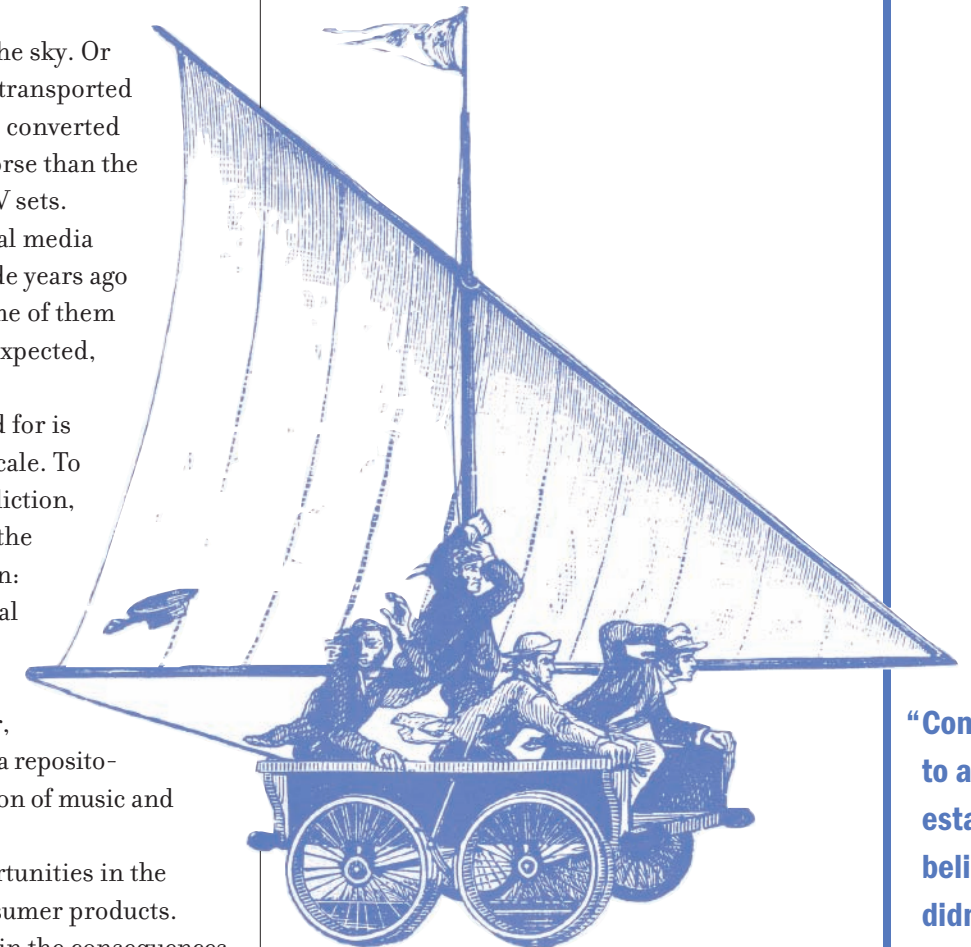
Seriously, what we hoped for is now happening on a huge scale. To risk a now much easier prediction, one can see three trends in the developments we'll invest in: wireless, mobility and digital entertainment. Does this mean, for example, we'll invest in an iPod competitor, or a home "media furnace," a repository and hub for one's collection of music and videos? Most likely not.

We don't see many opportunities in the devices themselves, in consumer products. Rather, we'll seek to invest in the consequences of the huge demand for the devices and services, in the upstream opportunities. These range from silicon for new wireless connections, to storage, to security, to management software, more generally to software now monetized as a service, to new classes of servers, and to new items we can't see yet on the list.

In particular, I'm personally curious to see where scale, size, bandwidth, and the sheer number of users will break the painfully cobbled together infrastructures. I am thinking of cable TV, cellular telephone, IP telephony, HDTV... Those breaks are the breaches through which insightful or lucky entrepreneurs and investors can move before the incumbents.

Even Nicholas Negroponte couldn't dream of hundreds of millions of cellular and now smarter phones, or iPod-like devices, or their many faceted combinations. From time to time we worry, where's the Next Big Thing going to come from—and we regularly underestimate the future.

My friend Guy Kawasaki, an ex-Apple Fellow and founder and Chairman of garage.com and author, most recently, of *The Art of The Start*,



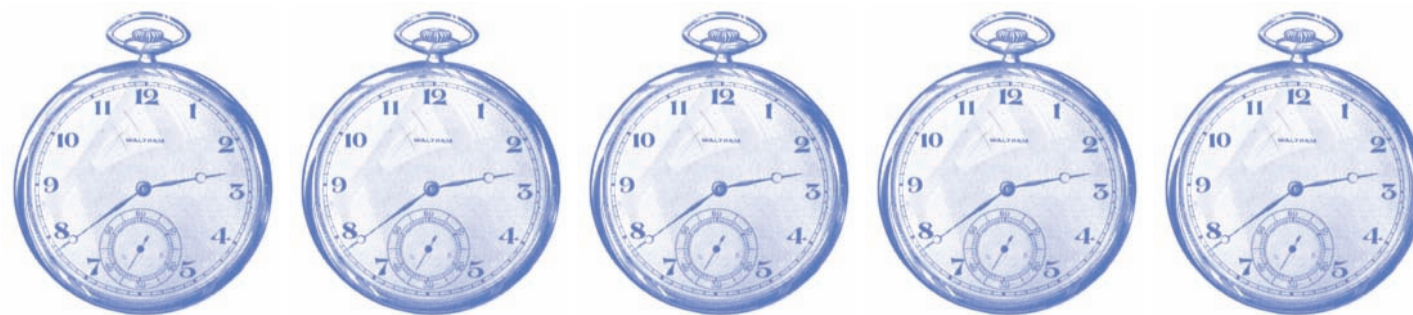
“Digital media were destined to pervade every aspect, every hour of our lives.”

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told an audience he made a \$2 billion mistake by turning down the opportunity to run Yahoo! in its early days. We have Alta Vista already. Today, even third fiddle AskJeeves is worth about \$2 billion. Contrary to a well-established belief, you didn't have to invest in Yahoo! or Google to make your Limited Partners happy. The next big things, plural, may not offer the next Google or the next Extreme Network—but these were not repeats of Intel, Apple or Microsoft either.

So, we think we know the *drivers* including wireless, mobility and home digital media. We'll look for the demand they're likely to create up the food chain and for the resulting investment opportunities. As for the *driven*, I mean the entrepreneurs, I have no doubt the united nations of Silicon Valley will continue to produce or attract the next wave of engineers and business men and women. ■

Visto: Synchronizing A Bigger, Hairier World



“Consumers are becoming hungry for data consistency in the increasing number of information ‘things’ they use.”

THIS COLUMN IS ABOUT ONE OF our portfolio companies, Visto, the problem it solves and, above all, what possessed venture firms to invest another \$65 million in the company in 2003 and 2004. That’s a question we must answer because the company was started back in 1996 and went through several “near death” experiences before getting this very robust new round.

In a previous newsletter, we encouraged entrepreneurs to come up with a concise statement of the genre, The Big Problem We Solve. In Visto’s case, the problem could be summarized in one word: Synchronization. The etymology of synchronize combines “together” and “time”—setting several watches to the same precise time, for example. From these origins, synchronizing has drifted into a related meaning, synchronizing files now means that the “same” file on two computers is indeed the same. For example, your calendar needs to be the same on your PC at the office, on your laptop on the road and on your assistant’s desktop. This was the founding idea of Visto.

Eight years after Visto was started, e-mail usage has exploded—pardon the bromide, but that’s indeed the way it feels to corporate IT, ISPs and We, The People as well. Besides PCs and laptops in the office, on the road, and at home, we have PDAs and cell phones. Vendors and carriers are pushing devices they like to call Smart Phones. Some devices such as RIM’s Blackberry and PalmOne’s Treo are quite accomplished. Others show promise, the promise of hundreds of millions of wireless mobile devices with e-mail, calendars, address books, music, photos, and business files.

In the US alone, a 2004 Yankee Group report sees 50 million mobile workers, with a 70% total addressable market, 35 million users of

wireless e-mail. Note the “worker” restriction, extend the market to consumers who also need to keep their “stuff” in synch, add fast-growing markets in the rest of the Americas, Europe and Asia and we can see the big B in The Big Problem We Solve and investors’ interest in being part of the solution.

But “The Problem” is much more complicated than it looks when stated as “just” synchronizing “my data.” We’ll limit ourselves to the most common need, synchronizing e-mail, calendars, and contacts.

In the first place there is no standard, only standards. Exchange—name your version, Domino, POP3, IMAP, other Personal Information Managers. Then, we have the devices themselves: PCs, PDAs, Smart Phones of every persuasion; and different operating systems within devices including Brew, Java, Symbian, PalmOS, Windows Mobile a.k.a PocketPC, Linux, all with their many versions. We’re not finished; we also have the wireless carriers, each one with their “evolving” infrastructures and their plans to increase the sacred ARPU (Average Revenue Per User).

Let’s try the minimal case. You have your own e-mail account with an ISP. Life is simple, your e-mail client on your PC checks your POP3 account and keeps track of what you received and what you sent. Then, you buy a Treo. It has a separate e-mail address and its own wireless provider. The first impulse is to send a copy of all your e-mail to the Treo and “make sure” you send a copy of your replies to your main account. A better solution is to use the software that comes with the Treo and lets your PC re-direct your mail to the Treo and keep it “in synch” for you. But that only works if you remember to keep your PC up and running all the time. Otherwise, no mail on your Treo.

There are other limitations. In general you see on the desktop, on your PC, the replies you made from the wireless device, but the replies you made from your PC don’t appear on your wireless machine. This limitation stems from storage size: my PC can store years of e-mail, my wireless device can’t.

For awhile, corporate users of RIM’s Blackberry have had the easiest life. RIM supplies a server your IT organization bolts onto Microsoft’s Exchange e-mail engine. The Blackberry device has no visible e-mail address of its own; it assumes your existing handle and gets a copy of all your e-mail. Your PC, your laptop can be turned off, your Blackberry gets a copy of your mail and, when you reply, the message will be flagged as replied to on your PC and a copy of the reply will be in the Sent folder. Further luxury: your calendar also synchs wirelessly. You change the version of your schedule on your Blackberry, the change appears on your PC and vice-versa. This also applies to your assistant if you set your Exchange account accordingly. This is luxury, even if the address book has to be synchronized “by wire,” meaning by connecting the two devices on your physical desk.

Is this a Blackberry commercial? Not quite, we’d rather call it a reasonable description of the target, of the opportunity. Today, RIM serves corporate users of Blackberry devices. Visto’s biggest opportunity is to offer even better services along two dimensions for more devices and more users, for a variety of devices from PDAs to Smart Phones and, beyond corporate users, to consumers.

We have, to be fair, glossed over the intricacies, the gotchas of synchronization. For example, you make changes to your address book on your wireless device and your assistant make different

changes for the same person in your Outlook Contacts file. When you synchronize, who “wins”? This is why Visto prefers to synchronize everything wirelessly, in real-time as opposed to delayed reconciliation. In the example just discussed, the changes you made would appear to your assistant before he enters new information. Delayed synchronization—that’s close to an oxymoron but it describes how many systems “work”—creates other potentially serious problems because errors in setting up which version “wins” can lead to losing weeks of updates made on the road—a personal favorite. You come back to your desk, press the synch button and, voilà, the old version erases all your updates. Hence our bias for real-time synchronization.

Naturally, Visto and its investors, while exceptionally savvy, aren’t the only ones to see how big the opportunity is, how wireless devices are becoming more pervasive and more powerful, and how consumers are becoming hungry for data consistency in the increasing number of information “things” they use. In other words, from Microsoft to Apple, from Yahoo! to AOL, from Verizon to Sprint to GSM carriers worldwide, many life forms, some extremely voracious, are thinking of ways to profit from what can justifiably be called a megatrend.

Visto’s challenge is that it isn’t one of these big players. This is also one of Visto’s strengths. The company can think and act more independently, it is not perceived as a competitor to the big guys (none of whom want to buy or rent technology from each other) and, over the years, the company has accumulated intellectual property that successfully met recent challenges. What is most important is that Visto has created and refined a broad set of software platforms and services covering the needs of consumers, IT

“The Problem is more difficult than it looks... there are no standards.”

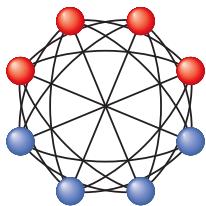
“The market may be a ‘mess’ but the enormous need and demand mean that the potential is huge.”

organizations and wireless carriers. For example, IT organizations and carriers are offered a choice of “behind the firewall,” meaning they operate their own Visto server, or they may opt for a solution hosted by Visto. From a world domination angle, some carriers might find it attractive to partner with an independent such as Visto, as opposed to a mightier entity, capabilities and appetites included.

But given the enormous complexities of the market and the endless war over standards and incompatibility of both hardware and OS’s, might a reasonable person conclude that this vast market is really just a huge mess? Carriers and their networks are changing—and sometimes falling, see exhibit AT&T—looking for ways to make money beyond voice. New, incompatible wireless mobile devices are announced every

week and some of them even ship. Normal humans are ambivalent: they see what these devices and services could do for them, but they also see the difference between their own messy everyday experience and the markitecture in the glossy brochures, the TV commercials featuring happy families, and athletic-looking road warriors who amidst all the technology manage to appear both intensely focused and completely relaxed. As a consumer magazine recently noted, we’ve come to trust used car dealerships better than some of the big technology players.

So, yes, it’s a mess. But the enormous size of it and the very obvious need that users have for simpler, safer, more secure solutions means that the market potential is huge. This is Visto’s opportunity to add value, to restore some modicum of consistency—on a very large scale. ■



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C A P I T A L

Allegis Capital invests in early stage companies developing enabling technology and infrastructure to serve emerging information technology markets.

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