Milestone Matters

Issue 37 Summer 2009

"I'm really proud of having had the opportunity to do this . . . this is the opportunity afforded to you in this country. I can build a company that really helps people." Tarek Sherif, Co-founder and CEO of Medidata Solutions on the occasion of the company's initial listing as a public company on June 25, 2009, the 41st anniversary of his emigration to the U.S. from Egypt.

Editor's Corner

Dear Friends, Investors and Associates,

I have a pleasant corner office with all the amenities I desire including my own espresso maker. It is a place where I keep books and photographs and paraphernalia that are thought inappropriate for my home and where my eccentricities rule, safe from the corrective inclinations of my well-intentioned spouse and the innocent intrusions of others. I think of my office not only as a work place but as the equivalent, of what the gentleman's study was in the Victorian era. So I am inclined to remain ensconced here, reviewing investment opportunities, meeting with entrepreneurs and communicating with the larger world, as required, via the wonders of the Internet et al. I know that Darwin, after his trip to the Galapagos Islands, rarely journeyed from his study for the remainder of his life and yet managed to complete his seminal work. But I am no Darwin and I know this pleasant sedentary, insular life is dangerous and so it was with a sense of anticipation that I left these comforts recently to travel to San Francisco to participate as a panelist at the IBF 20th Anniversary Venture Capital Investing Conference.

I encountered two sweeping and countervailing sentiments at the conference. By many measures, the venture community is going through a very challenging period. There has been no meaningful IPO market for young technology companies since 2000. The major effect of which has been that investors have received little in the way of profitable distributions. Merger and acquisition exits have been down as well and therefore have not provided a reliable alternative route to liquidity. Due to paltry distributions in recent years, institutional investors, who provide the bulk of venture funding, are shying away from committing more capital to VC firms. The consensus industry view is that a harsh winnowing is continuing and the number of firms will decline sharply – perhaps by 50% - from the current count of 760 which is already down from the peak of 968 a few years ago.

In sharp contrast to the above dark view, the preponderance of opinion is that the VC community is confronted with a huge opportunity over the next decade and beyond which will dwarf earlier innovative platforms such as semiconductors, PCs, biotechnology and the Internet. That opportunity is the Green Revolution in its multiple manifestations. This market is arguably broader in its applications, global in scope and actively promoted by the public sector and emboldened by political sentiment.

The almost exclusively American attendees agreed that ours was now a global industry. The ingredients of advanced technological education, industrial capacity and entrepreneurial inclinations are an advancing trio in many non-U.S. and non-European locales including, most dramatically, in China and India. These international entrants all at once, represent competition, a reservoir of talent and market opportunities for U.S. VCs.

A number of additional data points emerged:

- VC industry responsible for 18% of U.S. job creation
- VC-backed companies create 20% of U.S. GDP with 2% of invested capital
- Growth during the 21st century will equal that achieved for previous 20,000 years
- A VC-backed company requires 8 years to achieve an M&A exit
- A VC-backed company requires 9.5 years to achieve an IPO
- Plentiful cheap bandwidth and advanced PDA functionality will drive mobile communications growth
- VC fund raising down 40% in Q1 2009 relative to Q1 2008
- On average, over the past 5 years VCs have funded 1,000 startups annually
- Of these startups, 52% have been led by immigrant entrepreneurs
- The average value of a VC M&A exit in recent years is $55 million
- There are 1.2 million patent applications in backlog and about 150,000 are granted annually
- Since 2000, only 20% of IPOs raised less than $50 million
- Last year, 1 of every 8 U.S. marriages was inaugurated via the Internet

Other developments cast a shadow on VC prospects. These include the current burden of Sarbanes Oxley, the possible taxing of carried interest as ordinary income, the inclusion of VC firms as Investment Advisors under the jurisdiction of the SEC and the destructive application of FASB 157 (see spring newsletter) to venture portfolios.

Having exposed myself to all of these industry deliberations, I returned to New York with my intellectual batteries recharged and my VC enthusiasm enhanced.

With best wishes,

Edwin A. Goodman
General Partner

MVP Portfolio News

MVP II's portfolio company **Medidata Solutions Inc.**, received a favorable reaction from investors on its first day of trading as a public company. Medidata commenced trading on the Nasdaq Global Market on June 25, 2009 under the symbol MDSO. The company sold 6.3 million shares at $14 per share, above the expected price range of $11 to $13, raising $88 million.

NYC-based Medidata sells clinical data capture and management software to life sciences companies. The Company has seen its revenues grow from just over $600,000 in 2001 to over $105 million in 2008.

Milestone acted as lead investor building the syndicate for Medidata's first institutional round of financing in early 2002. Ed Goodman stepped off the board simultaneous with the offering. (See story on page 2.)

In mid May, MVP III invested $1.0 million in **IntegriChain, Inc.** ("IntegriChain"). Milestone led the $2.0 million Series B round with co-investor Cross Atlantic Partners also investing $1.0 million.

New Jersey-based, IntegriChain is a technology-enabled data services company that uses proprietary algorithms to provide data collection, integration, enrichment, analysis and reporting of sales and inventory activity exclusively for the pharmaceutical industry. The company's solutions enable its customers to improve sales performance and total pipeline measurement by maximizing transparency and accountability in each customer's down-stream supply chain. Current customers include Boehringer Ingelheim, Bristol Myers Squibb, Eli Lilly, King Pharmaceuticals, Novartis, Sanofi-Aventis and Takeda Pharmaceuticals, among others.

Morgan Rodd will serve on the board of directors.

The Medidata Win: Lessons Learned

Our portfolio companies, whether they are successful or unsuccessful, usually teach us something valuable about making money in the venture capital business. MVP II's investment in Medidata Solutions (NASDAQ:MDSO), an investment which as of July 30 has produced a 37x multiple of our original investment and a 1.6x multiple of our entire fund, is no exception. Below are a few observations:

1. Hustle, common sense can trump "proprietary deal flow"

Some VCs will only look at opportunities that fit a predefined "investment thesis," or have been referred by a trusted source. There is merit in this approach, but the early stage venture capital market is inherently inefficient, so the importance of "shoe leather" in the deal sourcing process cannot be underestimated. In fact, a company with huge upside can be hiding in plain site, like the compromising epistle in Poe's "The Purloined Letter," a story whose epigraph is "Nothing is more hateful to wisdom than excessive cleverness." After all, Milestone identified the opportunity at a garden variety networking/deal event in the fall of 2001 when the company had under $1 million of annual revenue. We subsequently led the first institutional round of funding for the company in February 2002 and joined the board of directors.

2. Out of favor markets often beat "hot" markets

When a market is "hot," Milestone reflexively becomes wary. When a market is poorly understood or shunned, but otherwise possesses powerful growth drivers, Milestone takes a keen interest. The healthcare information technology sector is a good example, as it has been out of favor with VCs for decades. Life sciences investors mainly focus on drugs and medical devices where intellectual property builds a meaningful barrier to entry and, conversely, IT investors are often are unable to get comfortable with the size and dynamics of healthcare niches. Medidata's market, electronic data capture solutions for clinical trials, attracted venture money for a few years in the late 90's, but the sector quickly lost its allure after the bubble burst. The irony of course is that customers were accelerating their adoption of this new technology in 2002. Thus Milestone made the right call to ignore the conventional wisdom that the EDC market was "crowded," and to believe that Medidata was at the right place at the right time.

3. First-time entrepreneurs with the right mindset can build substantial companies

We are happy to back serial entrepreneurs and experienced management teams. However, at the time of our initial investment in Medidata, Glen de Vries, Tarek Sherif and Ed Ikeguchi were first time entrepreneurs and did not have much management experience. Fortunately, they were really smart, had listened closely to their customers, and had developed elegant and powerful software. They evolved into entrepreneurs who were able to build a really big business because they were not afraid to fill the management ranks with the very best people in the industry and they were receptive to constructive input. For example, shortly after we made the investment, we met Steven Hirschfeld, who we believed was the ideal sales executive for Medidata, a company long on domain expertise and technology talent but lacking experienced sales leadership. Steve fortunately joined the company and made a huge contribution to the company's success.

4. Maintain a very high standard for customer due diligence calls

Customer calls are an opportunity and a potential trap. They are a trap if you have essentially decided in advance to make the investment, as only horrible calls will dissuade you from proceeding. But, ideally, customer calls should overwhelm you. Medidata, for example, had the kind of customer references you dream about. Their largest biopharma customer had assembled a really impressive cross-functional team to evaluate their alternatives. They were sophisticated, had conducted in depth due diligence of their own, and had decided that Medidata, despite its small size, simply had the best product, road map, and customer service attitude. Most importantly, it was clear they were going to spend a lot more money with Medidata in the future. When we got off the phone, we were really excited about making the investment.

5. Medidata: A case study for small funds and capital-efficient investments

We had a $10 million first close for MVP II in June 2001 and a final close in June 2002 at $13.1 million (MVP III closed at $54 million in October 2007). The consistent feedback we heard during the MVP II fund raising process was that our fund was too small and that our initial investments in early stage companies would get "crushed" or "washed out" in punitive follow-on rounds of financing – in other words, our companies would run out of cash and we would be unable to support them. We disagreed that this dynamic would be our undoing, as we were focused on investments in capital-efficient businesses from the start and were cautious about reserving capital for follow-on rounds. We were supposed to be fearful that Medidata was "undercapitalized" given that it was only raising $1 million when the dominant company in the market at the time, Phase Forward, had already raised a war chest of many tens of millions of dollars. But the reality is that the best applied technology companies need only a modest amount of equity capital to be very successful. After all, Medidata raised just $10 million of equity capital net to the company over its life before going public in June 2009 as a profitable company with over $100 million of revenue.

------*Todd T. Pietri, General Partner*

INVESTING IN EARLY STAGE TECHNOLOGY-ENHANCED SERVICE COMPANIES
IN THE NEW YORK METROPOLITAN AREA

Beginning in fall 2009, we will e-mail an electronic version of this newsletter to you. Printed copies will be available upon request.

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