Narrowing of the exits for semiconductor firms?

Ori Kirshner, Managing Partner at Giza Venture Capital, discusses the latest exit trends affecting Israel's semiconductor companies.

Ori Kirshner

IVCJ: It appears that that are fewer Israeli semiconductor company exits than a few years ago, and the exits that have been achieved are smaller in size than previously. Why is this?

Kirshner: There are not many exits right now in the general market, and the situation for semiconductor firms is no different. Passave and Oplus, for example, have seen significant exits in the past few years, but overall there has been a drop in their number and size. The IPO market has slowed to a crawl and while there are acquirers out there, most are unwilling to purchase technology alone. They *are* willing to buy companies with a customer base and market share. So, basically, the industry is in a waiting mode.

IVCJ: Many had high hopes that Saifun Semiconductors would be one of the major Israeli success stories. Yet, many investors were disappointed in its IPO valuation and aftermarket performance and the acquisition price paid by Spansion. How do you view this?

Kirshner: I regard Saifun as an exceptional case. Saifun is seen by many analysts as having been sold too late after it experienced difficulties on the business side. It probably was. Its technology is still considered excellent. Perhaps the company could have broadened its focus and revitalized revenues given a couple of more years. But Saifun, as a process company, is atypical for Israeli semiconductor firms. Process companies are even riskier than fabless firms. The main Israeli companies are those building chips in the fabless mode. This allows them to be closer to the market and maybe even climb in the value chain.

IVCJ: How much capital is needed for Israeli fabless companies to reach the commercial stage?

Kirshner: The cost to get going is between $25 and $40 million. So if a company can build a few products based on the same platform from within this area, then investors can see very acceptable returns and reasonable multiples. Still, it is optimal to build market leaders, and this means building an SoC to address a sufficiently large market with very strong, sustainable differentiation.

IVCJ: Can companies sell technology and expect to get a major exit?

Kirshner: You can't expect big valuations if you just bring a technology to the table. Those that are acquiring companies today are focusing on the business chain. They're looking for deals and market proof. This is key.

IVCJ: What else are acquiring companies looking for?

Kirshner: Many are looking for a horizontal play, like in the flash market, where the market is in the billions of dollars. They're not interested in a specific application chip.

IVCJ: VCs are known to examine the exit path even as they are making their initial investment in a start-up. How quickly do VCs want exits in the semiconductor industry? How long are they prepared to wait?

Kirshner: In general, Israeli companies are sold too early. In some cases entrepreneurs are seeking quick exits, or in other cases there might be pressure from some investors or partners to sell. The VCs are the ones that want to build the company. While an exit of $100 million to $150 million can be highly attractive to a company's founders, it's not good enough for the VCs. Our goal is $300 million and up in order to make six or seven times on our investment. So we have patience. At least five years are needed to build a company. And it's most important to build sustainable companies that are well-differentiated. Build it right and you'll have exit options.

The goal is to reach the full potential of the company. On day one we expect that each company will be a major success. Of course, we may find that the potential tops out at $30 million. We're realistic and know that not each investment will result in a home run. But we must keep our sights high.

IVCJ: Do you expect to see a decline in the number of exits?

Kirshner: The market is changing. More players are coming into the game, particularly from Asia. This is not raising valuations, but one can expect more M&A transactions than in the past.

Another factor is that cutbacks in R&D spending are taking place throughout much of the industry. When companies don't invest in R&D, they look to acquire technology. It's costly to build everything in-house. Companies want first to milk dry their current product line without being bothered by product cannibalism, and when that happens, to go for acquired technology.

Under current market conditions, mid-sized companies may have problems making acquisitions. Still, major firms, such as TI, Marvell and Infineon, remain very much in the acquisition game.

Also acquirers can come from a totally different direction such as system vendors. Last April, Apple bought P.A. Semi for its unique 64-bit powerful and power efficient technology. It's an example that the right combination of performance and power continues to entice strategic players. Still, the goal should be building companies with good technology and strong market position, and those companies definitely can go for IPOs. ■