Podcast Interview

Peter Longo, President and
Executive Director,
Connecticut Innovations
Interviewed by: Phillip Battle, SSTI

2007 Excellence in TBED Award Winner:
Increasing Access to Capital

Mr. Battle: Hi this is Phillip Battle with SSTI. The following recording is an interview with Peter Longo, President and Executive Director of Connecticut Innovations. Connecticut Innovations' Eli Whitney Fund was the recipient of the 2007 Excellence in TBED Award in the category: Increasing Access to Capital.

I asked him to describe the type of assistance provided by the Eli Whitney Fund.

Mr. Longo: Basically, entrepreneurs and companies come to us through many different sources from our network. Typically when we meet with an entrepreneur and they explain what they're trying to do, the first step is they provide us with an executive summary if they do have one. After that we would review the executive summary to see whether or not it fits our criteria. Assuming that it fits our criteria; we begin working with the company. Doing due diligence, evaluating their technology, their market and their competitive landscape in particular. As well as evaluating the entrepreneurs involved with the opportunity. Once that process is completed, they would come and make a presentation to the full investment team, who would then have the ability to decide as a group whether or not to move forward. Once the investment team agrees to move forward, the next step in the process would be to begin developing a term sheet, which would lay out the terms under which Connecticut Innovations, through its Eli Whitney Fund would be willing to invest in the company.

Once that is agreed to, we go to our investment committee at which time the investment committee gives us a thumbs up or a thumbs down. After that we would move towards closing on the terms that we've agreed to.

Mr. Battle: What stages of business development are you targeting with the program? Particularly I'm interested in hearing about what stage are these companies usually at when they come to you? Are you drawing researchers from universities? Are they serial entrepreneurs? Do they have a company intact when they come to you?

Mr. Longo: Typically, if we're talking about the Eli Whitney Fund, the Eli Whitney Fund is pretty much an early stage Series-A investment fund vehicle. We have other programs at Connecticut Innovations to help earlier stage companies, which we can talk about later. But the Eli Whitney Fund is generally dealing with companies that are pretty much at beta or beyond. Typically we are the first institutional investor in a company, or part of a round that will be their first institutional round. There may be angels or friends and family money in the company already. Typically it's a little more developed and ready to be commercialized.

Mr. Battle: Is there a business team in place?

Mr. Longo: Generally there is a business team in place.

Mr. Battle: So you're not involved most of the time in finding other people to come in?

Mr. Longo: Generally in the point of time with a Series-A there are gaps. Typically the gaps are generally around CFO types or sales types. Many times we're involved in helping bring other people into these companies to fill the gaps. But the gaps are small at that point in time. Maybe it's one or two people on the management team that are missing.

Mr. Battle: The program is pretty well known? People generally just come to you with these?

Mr. Longo: Yes, I would say that Connecticut being a small state, we are very well known to the service providers, accountant, attorneys, lawyers and groups out there that are working with these companies. So we're fortunate that there is a small group of people that we actively network with that send us our deal flow.

Mr. Battle: In recent years have put together as you mentioned the pre-seed and the seed funds. I think it's funded out of proceeds from the original funds?

Mr. Longo: Yes, we're an Evergreen Fund so all of our returns are recycled into investments and programs that we administer at Connecticut Innovations. We allocated $1 million to our pre-seed program last year and $4 million to our seed programs last year. We develop these programs as a way to accelerate the growth of innovation within Connecticut.

The pre-seed program is working with people at the very earliest stages, helping them develop their business plans, helping them develop their intellectual property strategies. Helping them obtain patents, licenses and so forth to help get them ready to the point of where they would be able to raise the friends and family in seed capital round.

The seed capital program is really the next step. So we have a program and a fund for that purpose as well to help get companies ready for their Series-A. We basically have a family of products along the life cycle that we're able to offer entrepreneurs in Connecticut.

Mr. Battle: Having those other earlier funds, has that improved the quality of the funds that are coming to the quality of the application?

Mr. Longo: It's kind of early to tell right now. We've launched the fund less than a year ago, those two programs. We are in process of having our first graduate from the pre-seed program to our seed program. So we're starting to see early signs of some success there. What we did notice is its helping accelerate the pace of creating opportunities in Connecticut.

Mr. Battle: Are you guy's technology neutral; are there any priority technologies that you're looking to develop? Specifically here I'm interested in whether the state has targeted certain industries for development, and whether that has any influence on your investments in addition to just investing in the most promising applicant?

Mr. Longo: Well we're pretty free to invest in any technology-based company in Connecticut. With that said, about a third of the portfolio is in the bioscience area, which is one of the areas that Connecticut is actively developing. As well as about another third of the portfolio is in the information technology area. The remaining technology areas that we typically are seeing in Connecticut investing in are the photonics, energy and environmental areas. We do invest in other technologies and have from time to time.

Mr. Battle: Connecticut Innovations has some other programs that are specific to certain industries, correct?

Mr. Longo: That is correct. We have a bio-facilities program that we manage, which invests in the build-out of wet laboratory space for biotechnology companies located in the state of Connecticut. It is structured as a low interest loan to the companies. We also have the Connecticut Clean Energy Fund that we manage for the state of Connecticut that is investing in the deployment of renewable energy technologies within the state. We also administer the Stem Cell Program for the state of Connecticut, which is a $100 million fund that the legislators created for that purpose.

Mr. Battle: Are there several companies that are involved with the Eli Whitney Fund that have also gone through those programs? Is that fairly common?

Mr. Longo: It is, especially on the bioscience side. We've invested in about eight or nine of our portfolio companies have taken advantage of the facilities program.

Mr. Battle: What is the typical deal structure you bring?

Mr. Longo: Within the Eli Whitney Fund the deal is our typically preferred stock instruments. Although we've invested in convertible debentures, as well as other subordinate debt structures with warrants. We generally try to have equity kickers structured into our deals. But we're typically structuring it to number one: meet the needs of the company, and number two: provide an adequate return for the risk we are taking.

Mr. Battle: On average what is the amount of time it takes for a company you guys have dealt with?

Mr. Longo: On average, it's between seven and ten years. It's been as long as 12 years in some companies that we've been involved with, but on average it's seven to ten years.

Mr. Battle: How do you monitor the progress of your investment? Do you include something that they have to turn in?

Mr. Longo: Well an investment manager would be assigned to be actively involved with a company. We typically join the board of directors of a company. We typically ask our companies to have monthly board meetings. Then there are other information rights that we have as part of the deal that gives us regular financial statements, regular business plans, and information that they are required to provide to us on a regular basis. We're pretty actively involved with the company, and I think that's part of why we've been successful. We put the effort forth and we basically put the time and energy to help these companies and guide them, and help them navigate through some of the mistakes that others have made before them.

Mr. Battle: What exactly is the involvement that you have with a company as soon as you become involved with them? What sort of mentoring do you offer? What sort of connections to the rest of the venture capital community do you offer?

Mr. Longo: Over the years we've co-invested with over 60 different venture firms. Clearly if it meets the criteria of one of those firms we would make the introductions and try to get other venture capitalist involved. We really like to leverage our investment so if in a Series-A we can bring others to invest with us, we absolutely would. We also introduce companies to some large institutions within Connecticut that could be potential customers. We also try to get them any kind of introduction they would need to help accelerate their growth. We're pretty actively involved. Each investment manager pretty much handles about eight companies at one point in time. We try to limit the number of companies so that they have the adequate time necessary to help nurture and grow these companies.

Mr. Battle: How frequently do you have follow-on investments to your additional investments?

Mr. Longo: Assuming the company is hitting the milestones and being successful, I would say it's pretty much 100% of the time that we will be following-on in these companies as they develop and grow. Most of the companies are going to need capital beyond a Series-A round, and we definitely allocate money towards those purposes. A typical Series-A size is about half a million to $1 million and we have the ability to follow-on over its life cycle up to $5 million in any one investment.

Mr. Battle: There is a lot that we've heard about Connecticut Innovations instituting private center practices that have really made the difference for the program being successful. Can you speak a little bit about that?

Mr. Longo: First and foremost, it comes down to the philosophy of the kind of staff we're trying to attract. We're really trying to attract those individuals that are the best and brightest that we can attract based upon some of the restrictions we have being a state entity. The real thing we're trying to do is operate, act, and think like a private VC would. With that said, clearly we have a double bottom line of obviously making a return on our investment, but in addition creating jobs and opportunities within the state of Connecticut.

I think what has made us successful is how we think, how we operate, and how we behave. Applying those private sector practices really helps us, not necessarily invest money in companies we don't think has a chance of success. We really don't try to swing through the fences. We try to invest in companies that generally are going to make it, and maybe they're not going to return 20 times your investment. But maybe they're going to return 5-6 times your investment, which would be a pretty adequate return for the risk we take. So we really try to operate, act and think like a private VC would.

Mr. Battle: Are you looking for companies that offer a 5-6 time return? Or are you aiming for 10?

Mr. Longo: What we're really looking for are companies that have a sustainable competitive advantage in the market place, have a strong management team, and have the ability to really develop into a stand-alone business opportunity, because everything else would come from that. If they're a company that's going to take $50 million to grow, and we're the only investor willing to put money in, it's clearly not an opportunity that's going to make a lot of sense to work on. So if the other VCs eventually aren't going to invest in this company, we will definitely steer clear of that.

Mr. Battle: A little off topic there. The companies have to remain in Connecticut, right?

Mr. Longo: Yes. We actually have a "put" in all of our agreements which give us the right to put back our investment to the company if they leave the state of Connecticut. What we're requiring in the state of Connecticut is headquarters, and a majority of the employees to be located here.

Mr. Battle: Do they have to promise any sort number of jobs over time?

Mr. Longo: We do look at the job growth over time, but they're not necessarily held accountable for that. So if they say they're going to create 100 jobs and they only create 80, there is no negative covenants for that. We do track, monitor and report the number of jobs created by these companies. It's clearly a factor that we look at when we make our investment decisions.

Mr. Battle: How do you publicize the number of jobs created or the amount of money attracted to the state?

Mr. Longo: On an annual basis we submit a report to the legislature that outlines those kinds of numbers.

Mr. Battle: So you guys have been very successful in turning profits from the funds to keep it self-sustaining. We hear quite a bit about similar programs trying to make the same jump to self-sustainability and haven't done it. Can you offer any insight into what's made it possible for the Eli Whitney Fund to do that?

Mr. Longo: I actually think that the biggest thing is time and patience. This is our 20th year that we've been operating as Connecticut Innovations. We came out of a predecessor corporation, but it does take time and patience. It took us some time to get there. We also had the good fortune of being involved in some companies that had successful IPOs, and returned substantial sums of money to us to help support the operations during the time when the public markets were really taking off. It really comes down to how we operate as well; I mean we're active investors. We really try to attract investment managers that have a real deep understanding and belief in the mission of what we're doing, and have the expertise to help these companies.

We also like to think, act and operate like our private VC friends, in how we evaluate opportunities and determining when to cut your losses. That's an important component to understand, is cutting your losses and not putting good money after bad. The other thing that we really do is we like to partner and leverage our dollars with other venture capitalists. So if we're investing in an opportunity that other VCs in some point in time won't invest in, then we're not necessarily investing in those business that are going to be sustainable over time.

I guess lastly, even though we are a quasi-public entity, we really don't allow political influence to influence our business decisions. I think that's an important factor that needs to be understood both at the legislative level as well as the executive branch level within a state. They really need to leave these entities alone, and let them do their thing, and not necessarily thrust them into investing companies that won't be sustainable just because of other relationships.

Mr. Battle: How have you guys been so successful in hiring people from the private sector venture capital markets to work for you?

Mr. Longo: Believe me it's not easy. We actually have a pretty diverse staff. We've been fortunate. We have some individuals that have been successful in their careers and this is sort of a second career for them. So they've already sort of developed to the point where they're looking to give back to society. Then we have another group of people that have been successful in their own rights, looking to get into the venture field and come here to learn how the venture business operates.

Generally those people have actually stuck around, because once they get here they get hooked on what we do and how we're able to help these companies be successful. We clearly don't have the same kind of compensation structure as our private VCs would, but it's important to try to create as much incentives as you can for performance based kinds of situations. We do have some programs that we have that are performance based to help when CI is successful to help share some of those rewards with the employees, although it's not near what private sector would be. So we have a combination of things that attract people to us.

Mr. Battle: You mentioned that you have existing relationships with a number of venture capital firms, and that if you run into a company that seems to be in their area of specialty that you will connect them with them. Are the companies you co-invest with the venture capital companies? Are they out of the Boston area, or are they more local Connecticut venture firms?

Mr. Longo: No, believe it or not, they're pretty much national firms. We've co-invested with many firms around the U.S. as well as international. We've been fortunate enough to create those relationships, and that is a very important component of what we do. Because if they're not coming into the Series-A, it's nice to know that they'll be there for the Series-B, and here's what the companies need achieve for them to be interested. So we do work very closely with the private VCs.

Mr. Battle: To wrap this up, is there anything you would like to add? Anything you could share with people that might be interested in your success?

Mr. Longo: I would say if anyone is interested in talking with us one-on-one, I'd be happy to speak with anyone out there who wants to learn more about CI, so if anyone is interested they can call me directly at 860-257-2330.

More information about Connecticut Innovations is available at: http://www.ctinnovations.com/. For more information about the Excellence in TBED awards, please visit: http://www.sstiawards.org/.