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**GLOBAL BUSINESS**

## **Where The VCs Are Flocking Now**

**A few years ago, Central Europe and Russia were shunned by big investors. Not anymore**

What's the hottest place to invest? That's always what any self-respecting venture capitalist wants to know. In 2004, Russian tech startups were clearly off the radar screen, as Sven Lingjaerde will tell you. Lingjaerde, a VC and founder of the European Tech Tour Assn., organized a visit to Moscow for 53 venture capitalists from the U.S. and Western Europe. At the time, none of the 25 outfits that pitched to the group got funding

Fast-forward three years, and it's a different story. Today, eight of those companies have secured Western backing. And by some estimates, three could be valued north of \$1 billion.

Finally, investors are starting to look beyond China and India and are pouring more time, energy, and money into the fast-growing economies of Central and Eastern Europe. At least \$500 million is sitting in funds targeting the region, and far more is coming from global outfits that see potential in the former Soviet bloc. With a deep pool of creative technology talent and a gross domestic product expanding at a rate of 6% to 9% per year, Eastern Europe is piquing the interest of VCs large and small. Says Yoav Sarnet, who oversees business development in the region for Cisco System ([CSCO](#))s Inc.: "As we look globally to where the next venture asset class is going to emerge, it's definitely Russia and Central and Eastern Europe."

Some VCs even say the region could soon rival India and China when it comes to spawning tech startups with global potential. While India has built a global hub for information technology outsourcing, little of the business is core research and development for cutting-edge products. Russians, Poles, and Romanians, by contrast, excel at the kind of creative development work tech startups need for breakthrough innovations, many investors say. "Central and Eastern Europe are already a better play" than China and India, says Scott Maxwell, co-founder of OpenView, which has invested 30% of a \$100 million global technology fund in the region. "The technologies are more sophisticated."

Venture investors say the region is a bargain, with the potential for finding blockbuster hits by exporting these startups' wares and knowhow to customers worldwide. Some think valuations of tech companies are as little as 10% of comparable outfits in the U.S. "You can make very small investments with mega-returns if the technology works out," says Richard Stokvis, a partner at London investment bank Europa Partners and a medical technology expert who advises venture backers in the region.

### **PROS AND CONS**

For the moment, Russia is getting lots of buzz, thanks in no small part to its huge and increasingly flush consumer class. Investors like the country's vibrant domestic market for Web and mobile phone services. And the potential profits in serving Russia's 150 million consumers is clear, thanks to successes such as Yandex and Ozon, Russia's answers to Google ([GOOG](#)) and Amazon.com ([AMZN](#)).

That has investors jumping in with both feet. Asset Management Co. in Palo Alto, Calif., run by legendary VC Franklin "Pitch" Johnson, has launched a \$104 million fund called Bioprocess Capital Partners. It will invest in Russian biotech and includes \$52 million from the Kremlin. Veteran tech executive Roel Pieper, based in the Netherlands, has set up a new fund primarily targeting Russian companies, including hydrogen technologies and light jets. And Alexander Galitsky, a Russian entrepreneur turned investor, is planning a fund later this year in partnership with unnamed Western VCs. "This is just the beginning," says Joe Bowman, an American working for Russian Technologies, a \$50 million early-stage fund based in Moscow. "We're entering a new era for Russian venture capital."

Diving into Russia, though, still carries plenty of risk, and for some the country remains strictly off-limits. With its rampant corruption, shifting legal environment, and competition from deep-pocketed locals, Russia can be a tough place for Western VCs. "One reason not to go to Russia is the amount of Russian money available," says Pekka Santeri Mäki, managing director of 3TS Capital Partners Ltd., which shuns Russia for Central Europe and is closing deals with two tech startups in Romania.

Indeed, Central Europe has no shortage of brilliant minds and promising technologies waiting to be set loose. New York VC Martin Jasinski visited 50 companies in Poland last year and was impressed with startup Medicalgorithmics, which recently received European approval to market a portable electrocardiogram monitor that sends data wirelessly to a patient's doctor. Medicalgorithmics is the first investment of New Europe Ventures, a \$75 million fund aimed at Eastern Europe.

While there's plenty of tech talent in the region, its companies are often less endowed with management chops. So some investors are providing financial and marketing smarts. U.S. and European backers of LogMeIn, a maker of popular software for remote access to PCs, urged the company to move its marketing headquarters to Boston, which helped put sales on track to double this year, to \$40 million. And Acronis, a Russian software house that makes disaster recovery programs, left its research-and-development team of 150 outside Moscow but moved its headquarters to Burlington, Mass., and hired an American CEO to pump up global sales.

One pleasant surprise for VCs is the red-hot Warsaw Stock Exchange. Last year, 38 companies raised a total of \$1.9 billion in initial public offerings in Warsaw—second in Europe behind the London Stock Exchange. That helped fuel a 42% rise in Warsaw's benchmark index in 2006. Since January, 19 more companies have gone public in the Polish capital, helping to push the exchange up by an additional 18% so far this year. In October the bourse will launch a secondary market tailored to listings for technology startups as it seeks to extend its allure as a regional exchange.

The winners on the Warsaw bourse could soon be joined by a handful of Russian startups that are eyeing public offerings. One is Yandex, a 10-year-old Web search company based in Moscow that has a 50% market share in Russia, vs. Google's 15%. Yandex' revenues doubled last year, to \$72 million, and a planned IPO could give the company a market capitalization of some \$1 billion.