



The Mercury News

MercuryNews.com

VC Deals: Hercules allows investment in pre-IPO start-ups

San Jose, CA

August 16, 2006

Most venture-stage investments are limited to institutions and wealthy investors who can afford to withstand potentially big losses for the chance to score potentially big rewards in start-up companies before they go public.

One way an individual investor can participate on a smaller scale is to buy shares in publicly held companies that focus on investing in, or loaning money to, private companies, hoping for big returns once those firms go public or are bought by larger companies interested in what they do.

One such company, Hercules Technology Growth Capital of Palo Alto, first offered its stock to the public in June 2005 when it sold 6 million shares for \$13 each, netting \$70.9 million. Its shares rose to just over \$14 within their first two months of trading, before tumbling to as low as \$9.63 in October. They closed Tuesday at \$11.83.

Hercules invests primarily in high-tech companies, usually through "mezzanine" debt financings coupled with an equity component such as stock warrants or options, in private companies previously funded by leading venture capital firms. The loans are typically secured by some or all of the assets of the portfolio company, according to Hercules' regulatory filings.

As a "registered investment company," Hercules receives certain tax breaks so long as it distributes to shareholders at least 90 percent of its net ordinary income and any net short-term capital gains it realizes that are greater than its long-term capital losses. During the first six months of 2006 it paid out \$6 million in dividends.

Because Hercules distributes most of its income to stockholders it needs additional capital to finance growth. It raised \$34 million in April, selling 3.4 million more shares at \$10.55 each less than a year after its IPO.

Hercules' largest shareholder is Farallon Capital in San Francisco, which owns 1.42 million shares, or 10.4 percent of Hercules stock. Farallon's institutional investors are primarily college foundations and endowments, according to its Web site.

Among Hercules' recent Bay Area investments are:

- Agami Systems of Sunnyvale, a networked attached storage company that received \$11 million in debt financing from Hercules. Agami's venture backers include Kleiner Perkins Caulfield & Byers, New Enterprise Associates, Apex Venture Partners and Alta Partners.
- Novasys Medical of Newark, a venture-backed company developing therapies in women's health, including a non-surgical approach to the treatment of female stress urinary incontinence designed to be performed in a physician's office or an outpatient center. Last week it received \$8 million of debt financing from Hercules.
- **BARRx Medical** of Sunnyvale, a medical device company focused on the treatment for a precancerous condition of the esophagus, which received \$27.8 million last month in a funding led by Montagu Newhall Associates, with existing investors Delphi Ventures, Alloy Ventures, Frazier Healthcare Ventures, Sutter Hill Ventures also participating. Hercules invested \$1.5 million in the round.