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Spin-Out Success Stories

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In association with Pembridge Partners

Corporate divestments receive less attention than spin-outs from universities, but high success rates for such ventures makes the concept worthy of closer examination.



Success rate high in divestments

It is not easy to put a figure on the number of corporate spin-outs created in the UK each year. Jim Osman, CEO of The Spinoff Report, which has been tracking and analysing global corporate divestitures since 2005, says there are between 30 and 50. A ten-year analysis conducted by the firm found that the general economic climate had no impact on either volumes or valuations of the spun-out ventures.

TMT (technology, media and telecommunications) spin-outs were most successful over that period in generating shareholder value for their parent companies. 'However, very few corporate spin-outs fail completely,' says Osman, adding that the motivation of management through share ownership is a key element in this success rate, alongside other factors such as support from the "parent" company.

Irish technology entrepreneur Pearse Coyle, founder of spin-out advice website CorporateSpinouts.com, explains that such opportunities often derive from a line of business that is profitable or growing despite receiving little management attention, or a product or piece of technology that was developed and never sold on, or perhaps only commissioned by a single customer.

In situations where the parent company wishes to focus on other aspects of its business, it may choose to allow members of staff or external entrepreneurs to take this product or technology and create a new company around it, Coyle adds.

The parent company sometimes – but not always – retains an interest in the new venture, either through equity or a stake in the intellectual property (IP). It might also provide funding, although in cases where the line of business already has a customer or customers it can be funded from cash flow. The thinking here is that small, nimble companies are often better vehicles for the development of innovative technology than large, lumbering corporations.

Market testing

New Venture Partners has been involved in more than 60 corporate spin-outs in the technology sector since it emerged as a spin-out itself from Lucent Technologies/ Bell Labs in late 2001. Partner Harry Berry, who previously established BT's corporate incubator, Brightstar, (which was later spun out of the telecoms giant) says determining the addressable market for each proposed spin-out is vital.

'We use a network of experts to test the technology to make sure it does what it claims to,' he explains. 'This research also addresses the market, because without demand even the most cutting edge technology is not commercially viable. Timing is key in the technology space to make sure that the market is ready for the application.'

Berry acknowledges that having a corporate as a route to market (if not a customer) is a major advantage. New Venture Partners has invested in ventures that are as much as two years from revenue, although for software products it would expect to get to market more quickly.

Risky business

An example of such a venture can be found on the outskirts of Dublin, where Irish software development firm Ability Software hopes to spin out an application that managing director Ronan Minogue says has potential across the financial services sector.

The company has developed a three-phase process that monitors certain events during the life cycle of an insurance claim and ensures the insurance company responds to the client promptly. Having delivered elements of the process to a number of firms in the UK over the past two years, Minogue says client feedback persuaded him that it had stand-alone potential.

'We have just pitched to a client in Ireland that has already bought the first phase, and we hope it will buy the entire package, which will validate it as a commercial product. We plan to create a separate company to commercialise the product, probably early next year, which will have revenue from day one.'

The creation of a separate company allows Minogue to bring in a couple of backers with contacts and experience that he believes will be useful in taking the product to market. For them to buy shares in Ability Software would have been too expensive and impractical.

The spin-out plan also makes it easier to raise further funds if required. 'If it was presented as Ability Software then it could be seen as a weakness from an investment point of view, as the potential investor is not being given a clear picture of what exactly they are investing in,' he explains.

Ability Software has identified around 80 target clients across the European and African insurance industry. 'If we signed up even ten of those we would have a strong business,' concludes Minogue. 'The process could also be applied to other sectors of the financial services industry.'

Knowledge assets

IP ownership is a vital factor for investors in spin-outs, according to Berry, who says there is little room for manoeuvre on that point from New Venture Partners' perspective. 'Ideally we want assignment [i.e. transfer of ownership], but we would demand at least exclusive field of use. Without either of these we would worry about the impact on future investors or future sale value.'

If the spin-out's management team is commercially savvy, that's an unexpected bonus, Berry adds, although the people who developed the technology 'are as much a part of the IP as the technology itself'. In this context, Dr Clive Dix is that rarest of animals – a multiple corporate "spin-outer".

Having managed successful exits from pharmaceutical firms Auralis and PowderMed (the latter of which he co-founded in 2004 and sold two years later for more than \$300 million), Dr Dix has spent most of this year planning the spin-out of a number of pain relief treatments developed by GlaxoSmithKline.

Approaching the VCs

When it became clear that GSK might consider spinning out some of its programmes, he contacted Simon Tate at the company's Neurosciences Centre of Excellence for Drug Discovery and found that he was thinking along the same lines. The two men devised a business plan, and while Tate worked to get it approved internally, Dr Dix was courting the VC community, with almost instant results.

'Within three weeks we had a letter of intent, which proved that VCs felt the plan was viable. GSK also moved pretty quickly considering it has limited experience of this type of venture – similar spin-outs in the past have taken up to 18 months.'

The end result was Convergence Pharmaceuticals, which was formally launched in October with over £22 million of Series A finance from Apposite Capital, New Leaf Venture Partners and SV Life Sciences, billed as one of the largest European biotechnology funding rounds in recent years. The company is fully funded for the next three years, and while Dr Dix says it is not expected to bring in revenues until 2017, it will generate data that will raise the value of the company and enable it to talk to potential partners about raising additional funds.

One of the reasons why VCs like pharma spin-outs is that they are very good at protecting their IP. 'You would expect a solid patent estate, which is what we have,' explains Dr Dix. 'We would not have received funding without owning all the IP.'

Of course, spinning out from a major corporation is no guarantee of instant success. VoxIQ founder Archie Macaulay, who started studying potential applications of speech technology in warfare while employed by BAE Systems, has spent the past three years pursuing customers for his automatic speech recognition platform.

'There are many situations in business where dealing with customers has a specified process and the rules are relatively simple,' he explains. 'Such processes represent around 92 per cent of operational costs.'

VoxIQ received initial assistance from BAE Systems, which has provided an exclusive, unfettered international licence for the technology while retaining the patents and a 10 per cent royalty on all sales that incorporate the patented invention. But Macaulay admits that his company had to work hard for funding to complete the product development process.

Awaiting success

Two years later, VoxIQ has yet to sign up a paying customer. However, Macaulay is confident that commercial success will happen. 'There is serious interest from the US in easing the completion of medical records and from India for a telephony-based service in a number of Indian languages,' he says.

Macaulay believes that spinning out from a multinational corporation 'is only helpful to the new venture if it is required to contribute to the multinational corporation's bottom line and the corporation sets up the spin-out to do just that'.

Coyle reckons management bandwidth is the challenge: 'Every good-sized company has within it a number of potential spin-outs. What are needed are schemes and incentives to push the management of established firms to look for such opportunities.'

Pembridge Partners advises entrepreneurs on growing their business, raising finance and preparing for an exit.



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