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# Crossing over

By *merging* venture capital & hedge fund *investing*, Michael Stark plays both sides of the tech coin to *winning* effect

BY IRWIN SPEIZER

Photographs by Ed Anderson

Michael Stark: *I was really into this process of innovation*



CROSSLINK CAPITAL



# When Michael Stark began hearing glowing reports

about First Solar, a company that produces solar cells and technology, he thought it might make a fine private company investment for his venture fund. But by the time he discovered the company's potential, it was headed for an initial public offering.

So Stark swapped hats, switching from venture capitalist to hedge fund manager. He bought into First Solar around the time of its IPO in November 2006, with the stock trading at about \$24. By December 2007, First Solar was trading at \$266.

The First Solar bet is vintage Stark, who moves seamlessly between private and public investments. His company, San Francisco investment firm Crosslink Capital, runs an unusual hybrid model that seeks profits across the spectrum of growth companies, from start-ups like First Solar to mature companies like Apple and Charles Schwab. Investors have the option of putting their money into a Crosslink venture fund, a Crosslink hedge fund or a Crosslink Cross-

in his first job out of college at Intel, he quit after deciding that the path to the chief executive's office was reserved for electrical engineers. Stark has a civil engineering degree, and he figured he might as well move on if being Intel CEO was not an option.

Today, at 55, Stark strives to keep his self-confidence from spilling over into the raw egotism that is so pronounced in many other hedge fund firms. His business card doesn't even list a title for him (he is general partner and portfolio manager). His corner office on the 22nd floor of one of the high-rises that make up the Embarcadero Center in San Francisco's financial district is no bigger than the other private offices at Crosslink. Stark says being in both public and private markets provides better intelligence and idea generation on both sides. "In terms of unearthing the markets that are best for new major company formation and to figure out who the winners will be, you have to do both public and private companies," Stark says. "Because we are seeing the full picture and not half the picture, we can do a better job. That is the essence of Crosslink Capital."

must have more technological knowledge and be able to build a company. In public work, you have to figure out whether a stock is attractive or not. That is a skill that either you have or you don't. What is very interesting is the fact that he has managed to pull both off."

Stark has managed to produce solid results in both formats. On the private side, Crosslink has run a number of venture funds over the years. Its Crosslink Ventures IV, launched in 2000 with \$225 million, posted a net internal rate of return of 13.66% through September 30, 2010. The benchmark Cambridge Associates median for venture funds started that year lost 3.4%, while the top 25% of funds posted a net 2.9% gain.

The Emerging Growth Strategy Fund, the flagship Crosslink hedge fund with approximately \$525 million in assets, was a finalist for the AR global equity fund of the year in 2009. Since its launch as a stand-alone company in September 1999, Crosslink has posted net average annual returns for its Emerging Growth fund of 14.3% from inception to the end of 2010, with a Sharpe ratio of 0.6.

The fund stumbled in the 2008 market collapse, losing 29% in a year when the AR Technology Index lost 13.85% and the AR Global Equity Index lost 3.65%. But Stark

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Seymour Kaufman, Crosslink Capital

over Fund that splits its assets between the two. The latest fund is the Crosslink Cross-over Fund VI.

Stark, Crosslink's co-founder, serves as the portfolio manager of both strategies, overseeing \$1.6 billion—approximately \$650 million of that in hedge funds and the rest in venture funds. Though it took him years to achieve entrepreneurial success, Stark has never lacked for self-confidence. At 26,

Michael Weisberg, a senior managing director at Crestwood Capital Management in New York, who has known Stark for years and worked with him in another company, has long been impressed with Stark's ability to successfully juggle the dual role of venture capitalist and long/short manager.

"Doing venture work requires a very different skill set from doing public market work," Weisberg says. "In venture work, you

still beat the Nasdaq, which lost 40.5%. And he quickly made up for the loss by outperforming in the next two years, gaining 38.1% in 2009 and adding another 11.6% in 2010. By comparison, the AR Technology Index gained 23.1% in 2009 and 8.14% in 2010, while the global equity index gained 18.55% in 2009 and 8.52% in 2010.

As its name implies, the Emerging Growth fund focuses on fast-growing

companies with a heavy concentration in technology stocks, generating ideas from a research team that works in both public stocks and private venture capital. The fund is long biased, with a net long position that varies from 30% to 70%. Stark employs no leverage and tries to maintain a mix of large cap, midcap and some smaller cap stocks in his long portfolio to capture the full range of growth companies.

The Crosslink portfolio generally maintains about 30 shorts and 50 to 55 longs. Crosslink will hold about 15 midcap companies that produce the biggest share of its profits and are the focus of most of its trading activity. Each of these positions tends to be sized at about 3% of the portfolio, for a total of nearly half of the portfolio's value. But the position size will fluctuate considerably and can go from zero to as much as 4% and then back to zero again in one year.

Another 25 companies with capital valuations of \$1 billion or less fall into what Stark calls "public venture capital"—public companies that are innovative and show prospects for rapid growth, similar to how private venture capital companies are expected to perform. Each of these positions accounts for about 1% of the portfolio. Unlike the top 15, which are actively traded as prices rise and fall, the 25 smaller company positions are held for about two years each, with a goal that their stock prices will double or triple. The rest of the long portfolio consists of two or three large cap stocks and several midcap stocks that are in transition, either being scaled up or down.

Stark uses pairs trading as part of his strategy, although he also places long and short bets without pairing them. He has frequently used pairs trading in his solar plays, where he views the strategy as particularly effective. For example, one of Crosslink's major long positions is Trina Solar, the Chinese manufacturer of rigid glass solar modules (as opposed to modules with a flexible thin-film structure).

Since these types of solar modules tend to be fairly similar, Stark surmises that Trina has a price advantage by being based in China, where operating costs are lower. While betting on Trina, Stark has gone short one of Trina's main competitors, SolarWorld, the German company that makes similar solar modules and has manufacturing plants in Germany, Oregon and Cali-

fornia, where costs are higher. Trina went from about \$16 last June to a high of \$30 on January 24. SolarWorld, which was about \$8 last June, rose to nearly \$12 in August before falling to \$7 in December and has been trading in the \$7 to \$8 range since then.

Recent long equity winners have included everything from Apple to Ancestry.com. Stark's long investments are based on one simple theme: finding companies that have developed an edge, often due to a technological advantage over competitors. In the case of Apple, Crosslink got in early on the theory that the iPhone was a breakthrough product. Crosslink had earlier made money with long bets on Research in Motion and its BlackBerry handheld device, but switched sides to Apple with the arrival of the iPhone and then the iPad.

Shorts, while an important part of the Crosslink hedge fund strategy, are not typically the biggest moneymakers. With its focus on growth stocks, Crosslink tends to make most of its money on long positions. Those long picks, in turn, are often informed by venture capital work.

As an example of how his system works, Stark points to First Solar. He started hearing about the company in late 2006 through a Crosslink venture capital investment company on which Crosslink held a board seat. Two top officers from that company decided to leave to join First Solar, saying they saw better growth opportunities there. Stark put his analysts on First Solar and decided it was indeed poised for rapid growth, so he began buying into the company through his hedge fund.

Stark says Crosslink maintains rigorous compliance systems to keep the firm out of regulatory trouble—an especially important function these days with the Securities and Exchange Commission and federal investigators cracking down on insider trading and focusing increasingly on tech stock investments. Crosslink keeps a list of companies that are off-limits to its traders because of possible conflicts, including those public companies where Crosslink holds a board seat, which sometimes happens when a venture fund company goes public. Stark is careful to avoid saying or discussing anything that might touch on the wide-ranging probe of insider trading, and he declines to say if he has used so-called expert networks, the information-sharing

research firms that link hedge fund managers to individuals with special knowledge about a field or company. The SEC has been probing expert networks as part of a broader crackdown on insider trading.

While he readily acknowledges that Crosslink's venture capital work can turn up tips that provide an edge to his hedge fund operation, Stark insists that the compliance checks are strong enough to keep Crosslink from crossing the line in its hunt for tradable information. Both the First Solar investment and an earlier successful short of chip maker Broadcom came about from information concerning personnel changes rather than corporate financial secrets, Stark points out.

While the discovery of fast-growing emerging tech companies is a central focus of both the public and private efforts at Crosslink, the long/short strategy also invests in well-known names that Stark sees as leaders in their fields. These companies are not necessarily tech companies, although they typically have some technological advantage over competitors.

John Rohal, general partner and managing director of Makena Capital, which manages capital for institutional investors and has been a Crosslink hedge fund investor since 2008, notes that Crosslink takes a global approach to its equity investments, using its venture work to help inform equity plays in emerging markets. Rohal points to Crosslink's investment in hiSoft, the fast-growing Chinese information technology outsourcing company.

"I think it was really their work with a number of other companies, and talking with them about the outsourcing of certain IT functions and who was doing it, that led them to hiSoft," Rohal says. "Michael is really good at understanding where technology is going at a particular time, how companies are taking advantage of those trends and how they are adding value."

One of the advantages Crosslink gets from its venture capital side is that much of the capital it manages in the hedge fund is locked up for much longer periods than in typical long/short funds. While pure hedge fund investors in the Crosslink Emerging Growth fund get quarterly liquidity with a 90-day notice, investors in the Crosslink Crossover Fund, which puts money into both venture funds and the hedge fund, are locked in for seven years, with the abil-

ity to withdraw just 5% every six months. That arrangement locks up a large chunk of capital in the hedge fund for an extended period of time, which gives Stark the luxury of being able to take a longer investment view than many equity managers subject to quarterly withdrawals.

Stark says he tries to maintain a collegial management style to encourage open communications between the venture and hedge fund operations. The 37-member staff includes teams of analysts and researchers who are divided into what Stark describes as a two-by-three matrix. The teams are split between private venture investing and public equity.

Within each of those investment types, they are then split among three sectors: consumer and business products and services, computers and software, and energy and semiconductors. The hedge fund operation also includes a small trading desk with two traders.

Stark's investment style is informed by the biographies he devours, and one investment icon has proved particularly influential. "What we do is similar to what

iversity as the first member of his family to attend college, using a combination of grants, loans and family assistance to pay his way. His first year was a shock as he discovered how unprepared he was for the rigors of a major university, yielding a string of C grades, including one in calculus, where he expected to do well. Humbled by the experience, Stark briefly wondered if he was up to the challenge. He dug in, determined to catch up to the best performers in his class, and by his sophomore year he was once again an A student.

One class left a lasting impression: an elective in electrical engineering, where the professor traced the history of electronic innovation, which Stark found fascinating. He began reading *Scientific American* magazine in his junior year to keep up with technological advances. He went on to the University of Michigan, where he earned an MBA with honors while pursuing his interest in the business of innovation at a time when others were more interested in corporate and financial management.

"I was really into this process of innovation," Stark says. "I just felt that so much of

by the same Michael Weisberg who would later become an investor in his fund.

Weisberg thought Stark's background with Intel was interesting but found his investment experience wanting. When the conversation turned to specific public companies, Weisberg offered up his view on one particular supplier to Intel and other chip makers. Stark bluntly told him it was the wrong bet and offered up a competing public company.

Weisberg's company clearly had superior management, Stark said, but the other company's technology would win out. The more Stark talked, the more Weisberg realized he had stumbled upon a genuine analytical talent. Stark got the job (and his stock pick proved to be the correct one).

He left in 1983 for an analyst job with Robertson Stephens, the San Francisco-based investment banker with a specialty in tech companies, where he encountered another tech investment specialist named Seymour Kaufman. Nearly twenty years older than Stark, Kaufman went from being an aerospace engineer in Southern California to a semiconductor analyst with a tech-focused investment bank in San Francisco. He then went to Robertson Stephens, where he became head of research and was Stark's boss for a while.

Kaufman eventually moved to a new team within Robertson Stephens that created one of the first crossover funds to do both venture capital and equity investments. Stark then joined Kaufman on that team to help raise new money and run the fund. They invested in a number of public companies that paid off handsomely, including McAfee (the Internet security software company), Seagate Technology (the computer storage technology company) and AOL. Among the private ventures was Dick's Sporting Goods, the retailer that they bought into as a private company and then guided through a successful and profitable IPO.

Kaufman remembers their partnership as an odd-couple marriage—Kaufman the voluble ex-New Yorker who delighted in schmoozing with clients and prospects, and Stark the all-business numbers cruncher whose people skills lacked polish. Kaufman likens the partnership to the old good-cop,

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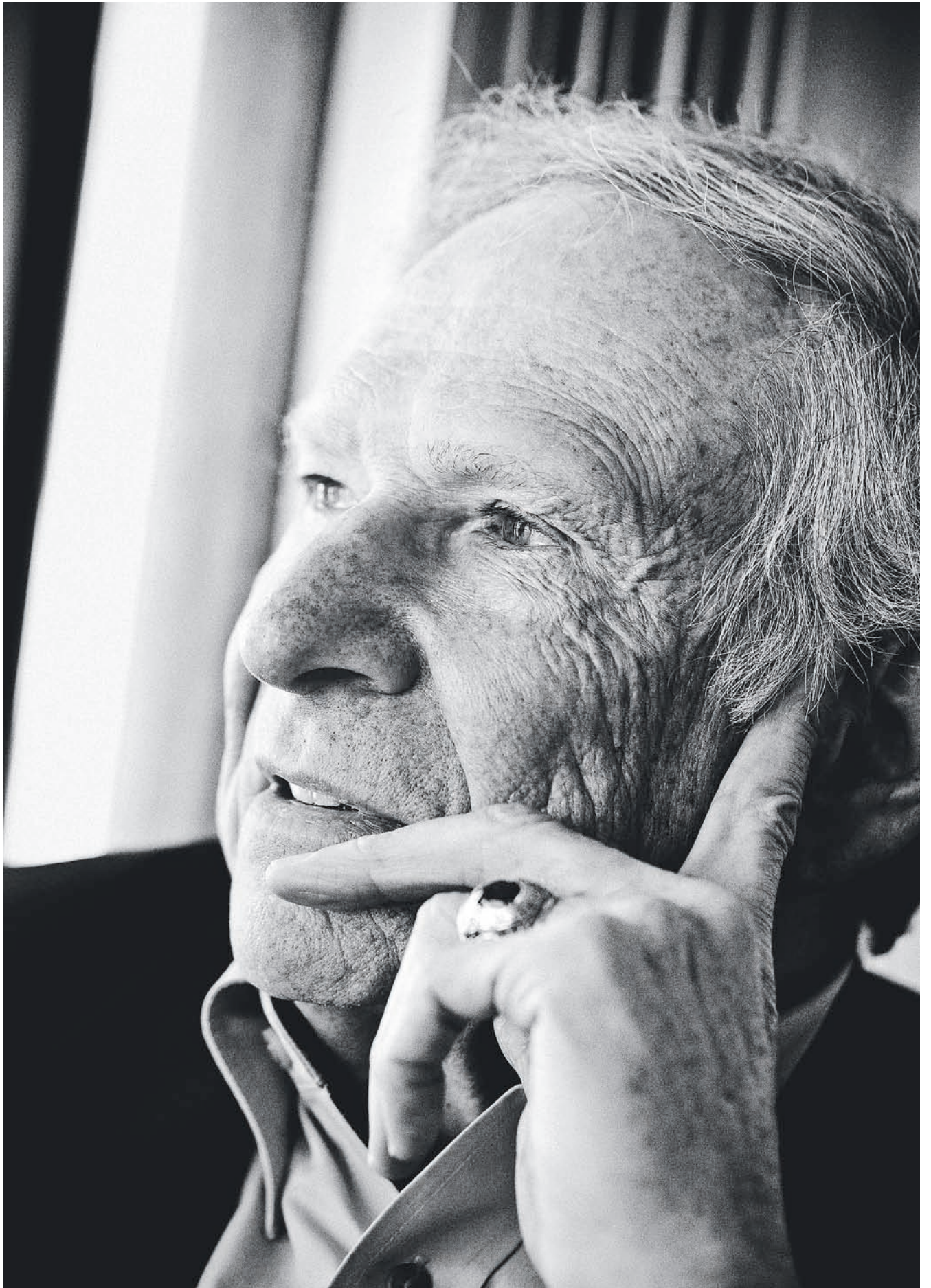
[Warren] Buffett does,” Stark says. “Sometimes he is an active investor, sometimes he is a passive investor. Sometimes he owns a whole company, sometimes he makes an equity investment.”

Stark also shares a Midwestern background with the so-called sage of Omaha. Stark grew up in Quincy, Illinois, a small-town regional hub of 40,000 surrounded by soybean and grain farms. Traces of the region remain in his diction; when he says “picture,” it comes out “pitcher.” He was the only child in a working-class family. His father was a service technician for the phone company; his mother a secretary.

Stark arrived at Northwestern Uni-

the wealth that was being generated came from the ideas of a relatively few people. That was so exciting. When I graduated, I thought the major innovation of my lifetime is probably going to be the information technology industry or the semiconductor industry, and the best company there is Intel. So I went to work there.”

He arrived in California in 1980, serving as a financial analyst and special projects team member in one of Silicon Valley's top companies. After he decided that the path to the Intel CEO suite was closed to him, he applied for a job as a semiconductor analyst with a small local equity research outfit. He was called in for an interview



bad-cop roles, with Stark in the latter.

It wasn't that Stark was openly egotistical or mean-spirited, Kaufman says, but rather that he was exceptionally confident in his skill and intellect and had little interest in anything other than the issues and tasks he was working on.

"Michael is scary smart," Kaufman says. "People were in awe of him, his mental ability and his discipline. You never went into a meeting with Michael unprepared.

"He is a highly focused guy, highly disciplined, absorbed with his professional

through the move, and Crosslink began operating with about \$300 million split between venture and equity investing.

The Emerging Growth fund took off like a rocket in the overheated tech sector of the time. It started with an 8.04% return its first month; for the year ended in December 1999, the fund recorded a net return of 72.94%, its best year ever, even though it was based on just four months.

The fund gained 24.99% in 2000, bolstered by the Broadcom short, but then stumbled after the tech bubble burst, down

According to the Crosslink filing with the SEC for the third quarter of 2010, its largest long positions were Ancestry.com, with stock that it valued at \$51.49 million; global data center operator Equinix (\$36.9 million); Chinese Internet company Baidu (\$36.05 million); and Trina Solar (\$33.2 million). Stark's portfolio is heavily into technology, including network security firms Adept Technology, Blue Coat Systems and Fortinet; AboveNet, which makes high-bandwidth products and services for networks; and BMC Software, whose products are used in cloud computing. The portfolio shows a continued interest in Internet companies, including OpenTable (online restaurant reservations) and eHealth (online health insurance), as well as alternative energy (Canadian Solar and Power-One).

For 2011, Stark is anticipating continued strength in global equities, particularly companies poised to benefit from economic growth in developing countries. He is bullish on cloud computing—using remote computer systems over the Internet in place of using in-house computer equipment—and figures that certain types of companies should benefit as corporations make greater use of the cloud. Among the companies to watch, Stark says, are data storage companies and Internet security providers.

If he had to pick one company that might be a breakout for the firm, he would choose one on the venture side rather than the hedge fund side. Crosslink is an investor in Pandora Media, the privately held Internet radio company that may be poised to go public in 2011. If it does, Crosslink would likely see a major payday.

Or not. As Stark is well aware, growth stocks are particularly vulnerable to economic downturns, and he has been caught off guard in the past by unexpected economic jolts that zapped his carefully constructed long book. "I think the same general trends of 2010 will continue in 2011," Stark says. "We have been seeing a little bit of a broader economic pickup. But sometimes events surprise us." **AR**

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*John Rohal, Makena Capital*

responsibilities, a consummate investor, a strategic and tactical thinker," Kaufman adds. "But he was a guy who had certain limitations at that time with regard to social skills. He was abrupt with people. Those skills dramatically improved over time, and he became much more articulate and personable. He has done a complete remake on the social side of his character."

After a series of mergers in the late 1990s, Bank of America ended up owning Robertson Stephens. That merger prompted a lengthy period of consolidation inside the new banking conglomerate. Stark and Kaufman opted to buy out their fund, which had been running as a fairly autonomous operation within Robertson Stephens. After the deal, Kaufman went into semiretirement, taking the less active role in the company that he maintains today.

In September 1999, Crosslink Capital, which had originally been called Omega Venture Partners, became an independent company. Its investors stuck with the firm

4.56% in 2001 and another 9.9% in 2002. The fund then posted strong gains in each of the next five years, capped by a 30.8% return in 2007. Its returns were powered by a series of prescient long plays.

But Stark's stock-picking prowess was no help in the market rout of 2008. He candidly admits that he was caught off guard by the bankruptcy of Lehman Brothers and the extent of the economic collapse that followed, and his long positions took a beating. But he was spared the harsh redemption run suffered by a number of other funds, thanks in part to much of his hedge fund money coming through the Crosslink Crossover Fund, which has a seven-year lockup.

Long plays paid off again in the tech rally of 2009, and the Crosslink portfolio got an extra boost when several companies in the Emerging Growth fund portfolio were acquired at attractive prices, contributing to the year's 38.1% gain. The fund settled into a more typical year in 2010, with no major mergers in its portfolio and an 11.6% gain.