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GSV Capital, Placing Bets on Start-Ups, Falters

By RANDALL SMITH

Few investors have ridden the recent Internet boomlet like the GSV Capital Corporation.

After GSV announced in June 2011 that it was buying a stake in the privately held Facebook, the closed-end mutual fund surged 42 percent that day. Capitalizing on the euphoria, GSV sold another $247 million of its shares, using the money to expand its portfolio of hot start-ups like Groupon and Zynga.

Now, GSV is feeling the Facebook blues.

When the public offering of the social network flopped, GSV fell hard, and it still has not recovered. Shares of GSV, which were sold for an average of $15.35, are trading at $8.54.

“We probably benefited from our stake in Facebook more than we deserved on the way up,” said GSV’s chief executive, Michael T. Moe, “and were certainly punished more than we deserved on the way down.”

GSV, short for Global Silicon Valley, is the largest of several closed-end mutual funds that offer ordinary investors a chance to own stakes in privately held companies, at least indirectly. Closed-end funds like GSV typically sell a set number of shares, and their managers invest the proceeds. In essence, such portfolios operate like small venture capital funds, taking stakes in start-ups and betting they will turn a profit if the companies are sold or go public.

“I think GSV was really innovative in creating a kind of publicly traded venture capital fund,” said Jason Jones, founder of HighStep Capital, which also invests in private companies.

But the shares of closed-end funds trade on investor demand — and can go significantly higher or lower than the value of the underlying portfolios. The entire category has been hit by Facebook’s troubles, with GSV trading at a 38 percent discount to its so-called net asset value.

Mr. Moe, 49, has previously experienced the wild ups and downs of popular stocks.

A backup quarterback at the University of Minnesota, he started out as a stockbroker at the Minneapolis-based Dain Bosworth, where he wrote a stock-market newsletter called

"Mike Moe's Market Minutes." He met the chief executive of Starbucks, Howard Schultz, on a visit to Seattle in 1992, and he began covering the coffee chain after its initial public offering.

"I left believing I had just met the next Ray Kroc," Mr. Moe wrote in his 2006 book, "Finding the Next Starbucks," referring to the executive who built the McDonald's empire.

After stints at two other brokerage firms, Mr. Moe became the director of global growth research in San Francisco at Merrill Lynch in 1998. There he ran a group of a dozen analysts at a time when mere business models "were going public at billion-dollar valuations," he said.

Shortly after the dot-com bubble burst, he founded a banking boutique now called ThinkEquity. At the time, he expected the I.P.O. market to shrug off the weakness and recover in a couple of years. Instead, it went into a decade-long slump.

"Market timing is not my best skill," Mr. Moe said. In 2007, he sold ThinkEquity.

The next year, he started a new firm to provide research on private companies, NeXt Up Research. He later expanded into asset management, eventually changing the name to GSV. Within two months of starting his own fund, he bought the shares in Facebook through SecondMarket, a marketplace for private shares.

GSV soon raised additional funds from investors and put the money into start-ups in education, cloud computing, Internet commerce, social media and clean technology. Along with Groupon and Zynga, he bought Twitter, Gilt Groupe and Spotify Technology. The goal is finding "the fastest-growing companies in the world," he said.

But Mr. Moe has paid a high price, picking up several start-ups at high valuations on the private market. He bought Facebook at $29.92 a share. That stock is now trading at $19.10. He purchased Groupon in August 2011 for $26.61 a share, well above its eventual public offering price of $20. It currently sells at $4.31.

Max Wolff, who tracks pre-I.P.O. stocks at GreenCrest Capital Management, said GSV sometimes bought "popular names to please investors."

"This is such a sentiment-sensitive space, the stocks don't trade on fundamentals," Mr. Wolff said, adding, "If there's a loss of faith, they fall without a net."

GSV's peers have also struggled. Firsthand Technology Value Fund, which owns stakes in Facebook and solar power businesses like SolarCity and Intevac, is off 65 percent from its peak in April. "We paid too much" for Facebook, said Firsthand's chief executive, Kevin Landis.

Two other funds with similar strategies have sidestepped the bulk of the pain. Harris & Harris Group owns 32 companies in microscale technology. Keating Capital, with $75 million in assets, owns pieces of 20 venture-backed companies. But neither Harris nor

Keating owns Facebook, Groupon or Zynga, so shares in those companies have not fallen as steeply.

GSV is now dealing with the fallout.

In a conference call in August, Mr. Moe was confronted by one investor who said, “the recent public positions have been a disaster,” according to a transcript on Seeking Alpha, a stock market news Web site. While Mr. Moe expressed similar disappointment, he emphasized the companies’ fundamentals. Collectively, he said, their revenue was growing by more than 100 percent.

“We have been around this for quite some time, and we are going to be wrong from time to time,” Mr. Moe said in the call. “But we are focused on the batting average.”

In the same call, Mr. Moe remained enthusiastic — if not hyperbolic — about the group’s prospects. Many of GSV’s 40 holdings are in “game-changing companies” with the potential to drive outsize growth, he told the investors.

Twitter, the largest, “continues to just be a rocket ship in terms of growth, and we think value creation,” he said. The data analysis provider Palantir Technologies helps the Central Intelligence Agency “track terrorists and bad guys all over the world.” The flash memory maker Violin Memory “is experiencing hyper-growth,” he wrote in an e-mail.

But Mr. Moe was a bit more muted in recent interviews. While he says he still believes in giving public investors access to private company stocks, he recognizes the cloud over GSV. “We unfortunately have a social media segment that got tainted. I completely get why our stock is where it is. It’s going to be a show-me situation for a while.”

Acknowledging some regrets, Mr. Moe said he was angriest about overpaying for Groupon, saying, “Yeah, I blew Groupon.” He said that he also did not anticipate what he called a deceleration in Facebook’s growth rate, and that it was “kind of infuriating” that some of its early investors were allowed to exit before others. GSV often must hold its shares until six months after a public offering.

But the downturn in pre-I.P.O. shares has a silver lining, Mr. Moe said. Since the Facebook public offering, he has been able to put money to work “at better prices.” He recently bought shares of Spotify at a valuation of about $3 billion, roughly 25 percent below the target in its latest round of financing.

The I.P.O. market is also showing signs of life, he said, with the strong debuts of Palo Alto Networks and Kayak Software. And he still has faith in Facebook.

Whatever its current stock price, at least it is a “real company” with revenue and profit, Mr. Moe said, adding, “It’s not being valued off eyeballs and fairy dust.”

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