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## The Un-Wild Bunch

Taking a cautious approach to investing—and avoiding dot-coms—Matrix Partners is the hottest VC firm you've never heard of.

BY LUISA KROLL

**T**HERE'S NO SUCH THING AS prescience—especially in venture capital. But in hindsight, the guys at Waltham, Mass.-based Matrix partners are looking pretty smart for sticking largely to the sidelines as dot-

comedy turned into dot-tragedy.

Founding partner Paul Ferri had an inkling of the coming disaster 15 months ago. That's when Stephen Nill, chief financial officer of a Matrix-backed company called VideoServer that builds networks for video conferencing, announced he was

quitting to accept the same post at then high-flying Furniture.com. Ferri hauled Nill into his office and asked him if he'd lost his mind. "Do you want to work with an experiment or a real company?" Ferri demanded. "And what do you know about furniture?"



No dot-com-compassion: Paul Ferri (second from left) has led Matrix Partners to one of the best records in the venture capital industry by staying away from trends.

When Nill left, Ferri called up VideoServer's founder, who then headed another Matrix-backed company, Sonus Networks, and told him to work on Nill. Result: Nill joined Sonus, a maker of communications switching equipment, which went public in May and has a market capitalization of \$6 billion. As for Furniture.com, it shut down in November.

"Paul's reaction really got me thinking about my future and about how phenomenally successful he's been with the companies he backs," says Nill.

Phenomenally successful—a phrase that rarely precedes the words "venture capitalist" these days. Not when some of the biggest names in VC are putting Cathy Freeman-like distances between themselves and their flops—Pets.com, Chipshot.com and Mortgage.com, to name just a few. Matrix is determinedly untrendy. "We don't try to predict emerging opportunities," explains Ferri. "We don't react to fads, and we don't change what we do."

What Matrix does is invest mostly in networking equipment and Web infrastructure. Companies like Phone.com, which sells software that allows mobile phones to access the Internet. It went public in 1999 and has a market value of \$7.5 billion; the \$3.5 million that Matrix put in is now worth \$498 million. Another one is ArrowPoint, a provider of switches to improve Internet content delivery. When it sold to Cisco this year for \$5.7 billion, Matrix got \$1 billion in Cisco stock for a stake that had cost it \$11.4 million.

The bets made by Ferri and his eight partners have been uncannily successful. Of its last 110 investments, the firm has lost money on only 10. Since 1990, Matrix says, its limited partners have enjoyed an average annual return of approximately 100%. Matrix V, a \$200 million fund raised in 1998,

may turn out to be the best-performing fund of all time, based on early distributions, reports Insider VC.com of Austin, Tex. Among its hits: Sycamore Networks, a communications firm that develops optical networks.

Matrix took some heat for its conservative approach. "People were questioning us two years ago," says Andrew Verhalen, a former 3Com executive who runs Matrix's office in Silicon Valley. "At some point we scratched our heads and asked ourselves if we were being too conservative."

It did make one calamitous foray into dot-comdom—a \$5 million investment in beauty e-tailer Gloss.com in 1999—but did so warily. One partner championed the investment, thinking he could bring technology expertise to a seasoned team of beauty executives. But within months the partners saw the business wasn't working—manufacturers were slow to sign up, leaving product-selection thin. Cutting its losses, Matrix sold the company to Estée Lauder on Apr. 12, two days before Nasdaq's steep plunge.

Matrix partners are quick to credit the loyalty of talented entrepreneurs who come to them with ideas. "They're the ones who see the tops of the waves as they come," says Verhalen. "They're much closer to what's going on than any venture capitalist." An engineer from Cascade, a high-speed switchmaker, and a marketing executive from Arris Networks—both Matrix-backed companies—approached the firm in 1998. Together they kicked around ideas for what would become Redstone Communications, a Westford, Mass.-based router company.

Much of the firm's discipline starts with 61-year-old Ferri, who has been around the venture block a few times. He started his first firm in 1977 with Warren Hellman, now an investor in Matrix. Hellman Ferri, as

it was called, produced yearly returns of 70% by investing in companies like Stratus, Apollo, even Midway Airlines. They got into Apple late in the game, buying an \$800,000 stake in 1979, when Apple had revenues of \$60 million. Hellman Ferri made \$16 million.

The firm was rechristened Matrix in 1982, when the West Coast office opened, because Ferri didn't like having people's names on the door. Hellman left around that time and Ferri brought in Timothy Barrows. The next two funds invested in everything from technology to retail to health care. Returns were good but not spectacular.

In 1990 Matrix looked in the mirror and didn't like what it saw: a patchwork of portfolio companies that made little sense in the aggregate. So the partners decided to narrow their focus to technology—and added partners with operating experience, including Apollo founder Andrew Marcovitz. They also vowed to invest only in companies that invited them into the first round of financing—as lead or co-lead investor, with a board seat.

That sort of commitment has paid many dividends. Serial entrepreneur David Skok, for instance, teamed up with Matrix for the first time in 1993, when it invested \$2.5 million in Watermark, which made document-imaging software. After the company became entangled in a patent suit involving Wang Computers and Microsoft, and began burning through \$130,000 a month in legal fees, most VCs curtailed their involvement with Skok. Matrix met with lawyers and helped Skok plan a course of action. Eventually the suit was dropped, and Watermark was sold to FileNet for \$64 million. When it came time to start his next venture—Silverstream, which makes application servers for businesses—Skok went straight to Matrix for funding. Says he: "We wouldn't dream of going anywhere else." ■

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