Up-and-Comer

Blackstone's Battery Mates

The bespectacled Scott Tobin (left) and Michael Brown have no shortage of vision when it comes to long-term performance.

Midsize Battery Ventures — quietly performing groundbreaking work — has won the support of private equity's biggest player

BY LEAH McGRATH GOODMAN

The tombstone of last year's $17 billion Freescale Semiconductor buyout features many of the usual suspects taking their bows, led by the Blackstone and Carlyle groups, respectively. A bit further down, you'll find a firm called Battery Ventures.

Who decided to cut a midsize Boston-based venture-capital outfit in on what was then one of the 10 biggest deals in history? None other than Blackstone itself, which has grown to respect the unconventional thinking of $2.2 billion Battery and, in particular, two of its younger partners: Scott Tobin, 36, and Michael Brown, 34.

Such respect has come from performance — specifically, a groundbreaking concept on which Tobin and Brown sold Blackstone after the rest of Wall Street deemed it untouchable: buying out, then turning around, an entire financial exchange.

The pair first floated the idea in 1999 when they began to notice a shift toward electronic trading, offering the potential to turn the exchanges — which had, essentially, long been staid old-boy's clubs — into growth machines. "It was a bit early for such a novel idea," says Chinh Chu, senior managing director of Blackstone's private-equity group. "The question of whether a private-equity or venture-capital firm could really change the fabric and the culture of an exchange to make it a for-profit organization had yet to be answered." Nonetheless, he was intrigued.

> "People called us crazy — but it's worked out well."

Tobin and Brown have a history of generating intriguing ideas. Tobin, from Great Neck, New York,

Photograph by JIMMY NICOL

ditched his academic inclinations for a chance to join a startup software company, then landed at Battery in 1997. He spearheaded a $15 million investment in Ximian in early 2001 that parlayed the company's Linux-based open-source technology into a tidy payout when Novell snapped up the company two years later. Brown, an Austin, Texas, native, has long understood that the Internet offered an opportunity to change old-line businesses; to that end, he helped lead BV's $62.5 million investment with Bain Capital in the largely overlooked Minnesota-based direct marketer Fingerhut in 2004.

On paper, financial exchanges presented the same technology-driven upside. There was just one problem: In 1999, no VC or private-equity firm had ever acquired a stake in an exchange; it was conventional wisdom that exchanges were financial minefields. "People called us crazy," Brown recalls. "They laughed us out of the room. They said exchanges were basically utilities, that everyone has a stake in them, that it was too political to bother with."

SCORECARD
Scott Tobin
Age 36
City Waltham, Massachusetts
Firm Battery Ventures
Position General partner
Education B.A. in Islamic and Middle Eastern studies with a concentration in international studies from Brandeis University
Career Arc Joined Battery in 1997, working on technology and financial-services investments. Previously worked at First Albany in corporate finance and ran corporate development at Future Vision, a venture-backed software company sold to Softkey International in 1995.
Really Big Deal Led Battery's $100 million investment in ITA Software.

"We just try to create a culture where the philosophy is always to seek new ground, to consider investments others aren't."

Enter the ailing London International Financial Futures and Options Exchange. After dominating the European bond market for years, LIFFE had just lost its top-earning bund-futures contract to the Frankfurt-based Eurex derivatives exchange, largely because it had failed to keep pace with rapidly evolving technology. This was an industry first: No exchange had ever been able to steal an entire market from another. Devastated, the old-guard LIFFE, which hadn't posted a profit since 1997, realized it was high time for a change.

Hammering out a deal took months, but Battery, with Blackstone its 50/50 partner, bought into the exchange in November 2000. Less than six months later, having closed its trading floor and shifted to all-electronic trading, LIFFE began posting a profit again. In 2001, under the tutelage of Battery and Blackstone, the exchange augmented management and developed enviable trading technologies. After reportedly fielding bids from rival markets Deutsche Börse, Nasdaq, the Chicago Mercantile Exchange and the London Stock Exchange, LIFFE sold for roughly $800 million to Euronext in October 2001, earning Battery and Blackstone more than $100 million each on investments a third that size.

SCORECARD
Michael Brown
Age 34
City Waltham, Massachusetts
Firm Battery Ventures
Position Partner
Education B.S. from Georgetown University in finance and international business
Career Arc Joined Battery in 1998, focusing on financial services, software and business-services investments, after working for two and a half years on a variety of debt and equity financings and mergers and acquisitions for Goldman Sachs's high-tech team. Was a financial analyst in Goldman's Financial Institutions Group from 1994 to 1996.
Really Big Deal Carved out a financial-services investing niche for Battery by driving home the LIFFE deal.

"That deal really opened up Pandora's box," says Richard Sandor, chairman and CEO of the Chicago Climate Exchange and an adviser in the LIFFE transaction. "It's amazing to me, because it unleashed about $60 billion in value in listed derivatives and more than $100 billion in the exchange space. Where I grew up, those numbers are pretty big." Given the consequent transactions involving the Nasdaq, the New York Mercantile Exchange and the Chicago Mercantile Exchange, it's hard now to fathom the struggle Battery endured.

Such is the curse of being a visionary, Sandor says. "I wrote a paper at Berkeley in 1970 suggesting that exchanges should be for-profit and electronic," he says. "I had been thinking about this for 30 years, but the technology wasn't there yet, nor was the mood to privatize exchanges."

BV and Blackstone remain somewhat demure about their possible future pursuits, other than to reveal their desire to continue co-investing, perhaps even in another exchange. "I think we've seen the biggest turning point we're going to see for a while," says Blackstone's Chu. "But there are probably still opportunities abroad — not in stocks, but in derivatives and options." Indeed, the two partnered last year in an ultimately unsuccessful attempt to outbid General Atlantic's play for NYMEX, which went public shortly thereafter.

"As soon as you do something that works, rest assured everyone else is going to mimic it," says Tom Crotty, BV's managing general partner and chief strategist. "But there's nothing proprietary here — we just try to create a culture where the philosophy is always to seek new ground, to consider investments others aren't considering."

That said, if the next step requires taking a risk or going off-grid to score a profit, Tobin and Brown are in. "You're always a little bit nervous when you're charting new ground," Tobin says. "But when it works out, it's terrific." D