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SBVP turns to secondaries to satisfy LPs' thirst for liquidity

The late-stage software investor managed to produce three exits in four weeks to end Q1 2024 even as exits via traditional routes drop quarter-on-quarter.

By Ryan Hibbison *(04-22-24)*

The stigma of selling on the secondary market may be fading as venture capitalists increasingly see the transactions as a legitimate way to generate exits in a market largely bereft of liquidity events.

Santa Barbara Venture Partners is the latest firm to openly share its experience of using the secondary market. It recently sold stakes in two portfolio companies, achieving hefty IRRs for both while returning capital to its LPs.

SBVP founder and managing partner Dan Engel told Venture Capital Journal he is baffled as to why more firms aren't taking advantage of the rapidly growing opportunity in VC secondaries.

"We have over 110 LPs now and almost all are individuals and we wanted to make them happy, that's our job," he said. "I really don't get why other VCs aren't doing the same. It's a strategy that some are quietly agreeing makes a lot of sense, but they aren't going to get loud about it because it will make them look bad."

It's a sentiment shared by Brad Svrluga, co-founder and a general partner of Primary Venture Partners, which recently completed a $95 million secondary strip sale to StepStone Group, generating liquidity for limited partners in its first fund. "Our job is to send money back to the pensioners, endowments and foundations we manage money for," Svrluga told VCJ in February. "These people rely on the liquidity."

More VCs may embrace secondaries as the exit markets remain moribund. From Q4 2023 to the first quarter of this year, M&A transactions dropped by about 6.5 percent to 2,022, IPOs dropped by nearly 40 percent to 66 and SPAC deals dropped by one-third to 10, according to data from CB Insights.

Origin story

SBVP, which is named after the California city it calls home, was founded by Engel in 2020 to invest in later-stage software companies, specifically targeting those with revenue of $3 million to $20 million-plus with strong growth metrics. The firm currently manages about $30 million and invests $1 million to $2 million per deal, focusing on helping its portfolio companies with marketing and customer acquisition.

"We specialize in recruiting LPs and having a roster of folks that are former CMOs, VPs of marketing, directors of demand generation, chief revenue officers, everything having to do with generating customers for B2B and B2C companies online, offline, you name it," Engel told VCJ.

The firm retains many of its LPs as advisers, including former CBS chief marketing officer George Schweitzer, former Papa John's CMO Bob Kraut, former Procore chief financial officer and chief strategy officer Rusty Reed, Lead Edge Capital founder Mitchell Green and longtime marketing and management specialist Richard Townhill, who has worked at Adobe, Airbnb, Apple and PayPal.

SBVP closed its debut fund at $11.3 million in June 2022 after nearly two years on the fundraising trail. The firm invested in 10 companies and has since achieved a total of four liquidity events, three of which were completed between February and March of this year.

Its first was a traditional exit. Classy, which makes fundraising software for nonprofits, was acquired by GoFundMe in May 2022. Engel said that the deal was a "stock-for-stock" transaction. On paper, the sale of Classy generated a gross IRR of 27 percent, according to documents shared with VCJ. But SBVP's return is still locked up. Engel said he and his partners expected GoFundMe to go public soon after the deal, but the IPO market closed, so they were unable to generate cash to return to LPs.

Because the stock-for-stock transaction hadn't gone the way he'd hoped, Engel decided he needed to address LPs' concerns about liquidity another way. "Our LPs had ongoingly been asking for opportunities to cash out in line with the returns that we promised, and that's when we decided to get creative," he told VCJ.

The firm's next exit took 18 months to complete. Bark Technologies operates a parent-controlled monitoring platform for teenagers and uses artificial intelligence to identify when children are engaged in potentially dangerous activities online. SBVP first invested in the company's $10 million Series B round in 2020. When the firm started exploring a secondary sale for its stake about a year and a half ago, it was initially disappointed.

Potential buyers "were ignoring what the company had accomplished and the results [achieved] since their last round, and they all expected to have a discount to the last round," he said. "That didn't make any sense to us to just ignore that ARR had almost doubled in that time. So we waited until we found a party willing to do what we felt was appropriate and pay a premium to the last round."

SBVP ended up selling 25 percent of its stake in Bark to an undisclosed buyer and achieved a gross IRR of 33 percent, according to documents shared with VCJ.

The firm's second sale on the secondary market proved to be its most profitable to date. Rad AI, an automated report generation platform for radiologists, was looking to raise its next round of financing and one of its investors was looking to acquire a larger stake. SBVP, which had invested in Rad Al's $25 million Series A round in 2021, took the opportunity to sell 10 percent of its stake, generating a gross IRR of 44 percent in two and a half years, according to documents shared with VCJ.

“We think it’s going to be one of our biggest winners, so we don’t want to sell a large stake, but it’s growing 200-250 percent a year,” Engel explained. “If we sold 10 percent and produced this great return, sent more capital back to our investors, how long would it really take us to recapture that 10 percent that we sold at that growth rate? Not very long.”

SBVP was able to achieve a fourth exit recently through traditional M&A. In February, DraftKings bought port folio company Jackpocket, a lottery courier software developer, for $750 million cash. While the exit came as a welcome surprise to Engel, its impact on the overall fund performance has not yet been calculated according to the documents the firm shared, leaving its two secondary transactions as the sole drivers of distributions to LPs.

SBVP is currently in the market raising its second fund. While Engel declined to discuss the fundraising, he did say that the recent liquidity events have helped his firm over the hurdle of raising a sophomore vehicle.

“Before we had these exits, especially when the market was in its worst place, we saw 30 percent or less of the people we were meeting with for Fund Il say ‘yes,’ and now that we’ve had the exits it’s more like 80 to 90 percent,” he told VCJ. “Now [LPs] are saying, ‘You produced the money from which we could put it into the second fund.’ We’re seeing a very large participation rate in our second fund, which was not the case six months ago before we had any cash-based exits.”

Engel isn’t done yet, though. He explained that SBVP is exploring a secondary sale in an unnamed company it backed in 2020. The company raised two more rounds during the market-peak valuations in 2021, but those valuations no longer feel realistic.

“We could potentially make someone really happy who feels like they’re getting a humongous discount on what someone paid two phases after we did even though the company didn’t really grow during that time,” Engel told VCJ. “They could get maybe half off what the market peak was and yet we would still get a 2x return!”

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