

IVCA Private Equity Profile



Neutral Tandem, Inc.

Ron Gavillet, Co-Founder, General Counsel and Executive Vice President of External Affairs

Venture Capital Partners: Doll Capital Management, New Enterprise Associates, Mesriow Financial, Montagu Newhall Associates, Inc., Wasatch Advisors, Inc.

Headquarters: Chicago

Chicago reigns as a leading transportation center, connecting millions of people and products to their destinations. It makes sense, then, that the city also serves as a nerve center that links hundreds of millions of callers across the country and delivers reliable and affordable voice communications.

Phone calls from one carrier to another require switches, or tandems, to join them. Previously, only existing telecom companies provided these tandems, and they had little motivation to improve upon current methods or make tandem switches available to their competition. Eventually with this system, traffic bogged down the switches and per-minute usage fees charged among competitors trickled down to consumers.

But one company – Neutral Tandem, Inc. – found a solution. Founded in 2003, the company operates on the principle that an incumbent shouldn't own tandem networks; instead, an independent party should operate them. The founders so passionately endorsed the concept that Ron Gavillet, Neutral Tandem's general counsel and executive vice president of external affairs, quickly raised the capital to buy switches and authored the firm's initial patents to become that independent connection provider.

The model rapidly broke monopolies on the interconnection facilities. Today, from its Chicago headquarters, Neutral Tandem provides service to nine of the top 10 wireless carriers in the United States, which account for 80 percent of the country's total wireless subscribers. It serves more than 50 markets in the U.S. and continues to expand its reach.

This independent alternative reduces communication costs by allowing providers to avoid incumbents' per-usage charges. This lowers costs for consumers, while also providing top-of-the-line technology and service.

Neutral Tandem's technology also alleviates congestion and busy signals in everyday use, resulting in greater reliability. Further, it furnishes a second level of call-connection capability, providing an important security benefit in emergency situations.

Neutral Tandem by the Numbers

- **51—U.S. markets served, including metropolitan areas like New York, Chicago, Los Angeles, Atlanta and Seattle.**
- **60—Major service providers exchanging traffic through Neutral Tandem.**
- **115—Employees, including 70 in Illinois.**
- **185 million—telephone number endpoints served**
- **3 billion—minutes of calls connected each month.**

Neutral Tandem's originality and affordability are paying off. Revenues multiplied by 15 times between 2004 and 2006, to \$52.9 million from \$3.4 million. And a company that started with one employee now supports 115 jobs, more than half of which are in Illinois.

The company also has achieved growth entering new markets. Today, a spider web of independent tandems extends from Boston to Los Angeles, Minneapolis to Miami, and points in between. Yet Neutral Tandem's growth and its innovative technology have not come without expenses. The rising costs of switches, entrance to new markets and operations led its executives to seek capital from investors looking for a prime opportunity.

Raising Venture Capital

Since 2003, Neutral Tandem has tapped venture funding three times. Initially, Mr. Gavillet sought capital to purchase interconnecting switches, to obtain patents and for expenses associated with establishing the company. He handled this early work from a kitchen table.

Two firms invested initially in the company—Doll Capital Management and New Enterprise Associates. Both firms focus a lot on start ups, especially in the technology and communications fields. As Neutral Tandem began to grow, further investments became critical to its success and, in its second bid for capital, the company caught the eye of Chicago-based Mesirow Financial.

Neutral Tandem's Venture Capital by the Numbers

- **3—Rounds of venture funding.**
- **5—Number of venture capital firms that have invested in the company.**
- **15—Fold rise in revenue in two years, to \$52.9 million in 2006 from \$3.4 million in 2004.**
- **47.5 million—amount of investment dollars raised.**

Mesirow, as a limited partner to Doll Capital, had followed Neutral Tandem's development and liked its experienced management team and well-executed business model. By the end of 2004, Neutral Tandem was moving toward a positive cash flow model and also was building its network

nationally. In November 2004, Mesirow became the newest outside investor in a series B investment pool as the three firms provided more funding for Neutral Tandem's continued expansion and success. By the end of this series, Neutral Tandem had raised \$35.5 million in investment funds.

In 2006, Montagu Newhall Associates, Inc., led a third round of funding. Neutral Tandem's initial three investors along with Montagu Newhall and Wasatch Advisors, Inc., invested \$12 million, which allowed Neutral Tandem to continue growing its network, enhancing its technology and creating national marketing initiatives.

As Neutral Tandem continues to expand into new markets and maintain customer satisfaction, it is establishing itself as a leader in the industry and generating an appeal to consumers, regulators and investors.

Running the Venture Capital Course

In a field like telecommunications, rapid change proves the norm. What was fresh yesterday may be ancient next week, so it's critical to grow and innovate simply to keep up. As people become increasingly mobile, so must their communications.

In its first four years, Neutral Tandem has moved swiftly and now connects people for billions of minutes of conversation monthly through more than 150 million endpoints. Its progress has taken the company through the venture capital course in just four years. In early 2007, the company filed with the Securities and Exchange Commission for an initial public offering of company stock to pay for continued expansion of its business.

From a kitchen table to, soon, a stock table, Neutral Tandem has established itself as a technology leader in just four years. Venture capital paved the way for the company's growth and its bright future as the premier independent telecommunications tandem company delivering easier, more affordable services to consumers. That's a win-win outcome for all.

The **IVCA Private Equity Profiles**, a continuing series of portraits of Illinois venture capital and private equity investments, spotlights companies that are emerging or proven successes. Each account furnishes information about the company and the private equity firm or firms that invested in it, illuminating the important role they play in nurturing the companies.

IVCA is a non-profit trade association that serves the Midwest venture and buyout community. It focuses on expanding the size of the industry in Illinois and the Midwest by improving the local ecosystem for investors, entrepreneurs and limited partners. On behalf of its members, IVCA advocates pro-growth government policies, provides a virtual community, via www.illinoisVC.org, for deal flow and networking, and hosts educational and entrepreneurial events that offer networking opportunities for local investors, entrepreneurs, governmental stakeholders and tech-transfer groups.
