

China Venture Capitalist Confidence Index™

(Bloomberg ticker symbol: CVCCI)

First Quarter – 2007

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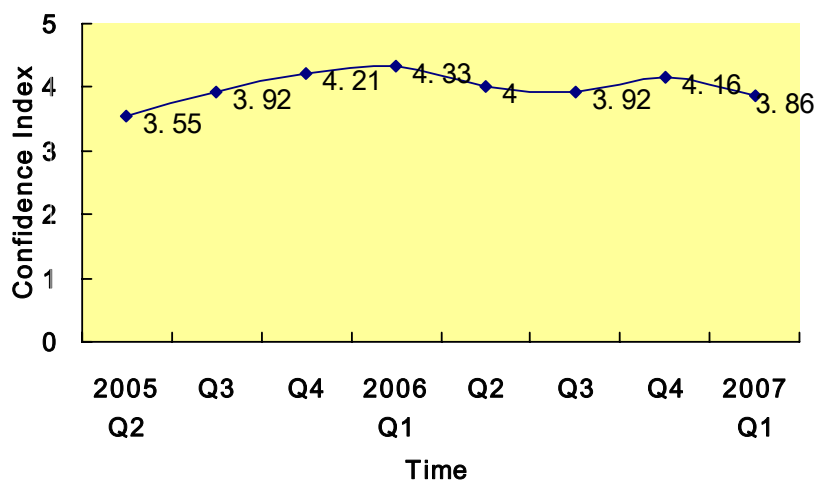
The quarterly *China Venture Capitalist Confidence Index* (Bloomberg ticker symbol: CVCCI) is based on a survey of mainland China and Hong Kong venture capitalists. The China VC Index measures and reports the opinions of China-based professional venture capitalists in their estimation of the high-growth venture entrepreneurial environment in China over the next 6 - 18 months.

In publishing a recurring confidence index of China-based venture capital investors, we intend to utilize the local knowledge and insight of our respondents to provide an on-going leading indicator of local investment in new high-growth businesses in the Greater China Region. We expect that this local insight will provide a unique perspective into the dynamic Chinese entrepreneurial business environment. Further, by tracking what local venture investors project about the high growth venture environment rather than what has already occurred in terms of investment flows, we hope to provide actionable insight for all interested parties.

The venture capital industry in China is in a relatively early stage, and significant change is likely to occur in it in the near to mid term. These reports and index readings are intended to provide a base-line from which to compare the relative gain or loss of local professional investor confidence in the environment for investment in high-growth ventures in China.

The China Venture Capitalist Confidence Index for the first quarter of 2007, based on an April 2007 survey of 12 mainland China and Hong Kong venture capitalists, came in at 3.86 on a 5 point scale (with 5 indicating high confidence and 1 indicating low confidence). This quarter's reading is down from last quarter's index of 4.16. (Please see Table 1 for trend data.) The index reading has been fluctuating

Table 1
Trend line of China Venture Capitalists Confidence over recent 8 quarters



in recent quarters, but continues to point to a relatively upbeat perspective in venture investor

confidence.

This report's commentary and index reading* are based on a sample size of 12 venture capitalists in the China region. All of the Index respondents' names and firms for this report are listed in Table 2, save those who wished to remain anonymous. Some of the responding venture capitalists also provided commentary that supported their degree of confidence in the near term venture investment environment. In the following, we provide many of their comments along with our analysis.

The declining index reflects venture capitalists' concerns over possible changes in government policies and increased competition for good deals. Some venture capitalists remain conservative in forecasting the future venture investment activities due to pending government policies. Specifically, Marvin Lai of iTM Ventures offered that, "The recent hype of the Chinese stock market has prompted the People's Bank of China (PBOC – Central Bank of China) to raise lending bank's reserve ratios to 11% in an attempt to 'cool' the economy. This interference, though not yet effective, will send a negative signal to the investment community as a whole, and it is most likely to create an adverse effect for all sectors in China in a few months to come." Additionally, two anonymous VCs gave 3 out of 5 as their confidence index. One attributed his lower rating compared to that of last quarter to "regulatory uncertainties in China that are making VC activity hard to predict". The other anonymous VC claimed that she's still "waiting for all policies to be announced and action to be taken by the Chinese government". She also believes that the uncertain US housing credit and consumption confidence will negatively impact venture investment in China. In addition, Michael Scown of Intel Capital noticed that, "Overall returns are likely to moderate given the increased competition for deals as new investors enter the market along with a general move toward later stage investing." He continued, "There has been a significant blurring of investment targets among VC's, PE and hedge funds at some deal sizes."

Despite the cautiousness brought on by possible changes in the investment environment, most venture capitalists hold an overall optimistic sense about the high-growth venture activities in China. For instance, an anonymous VC stated that "Optimism in my business contacts is high". Another VC respondent indicated that his firm is "optimistic on the market but not in the extreme". Max Burger-Calderon of Apax Partners Ltd explained his optimism by noting that, "The learning is very high paced and, accordingly, the progress by all parties involved. The gap between the benchmark (Silicon Valley type environment) and the mainland is narrowing at a fast pace." Additionally, Johannes Schoeter from Victoria Capital Limited attributes his confidence to a "Huge founder wave of new businesses on a scale as nowhere else in the world – 400,000 private companies are founded together with continuing strong inflow of high quality strategic foreign investment". Harry Man with WI Harper Group agrees with Mr. Schoeter, stating, "China still remains a hyper growth country and the macro environment is getting more and more favorable for entrepreneurs. In terms of fund raising, there is plenty of money rushing into China. In terms of exits, increasing international stock exchanges are trying to attract good companies to go listing. On top of these two key elements, government support, the talent pool, and other factors are all forming a right eco system for healthy development of a venture business in China."

Despite his concerns of lower investment returns in the future, Michael Scown of Intel Capital still believes in great growth potential in new ventures in China because "there has also been increased

movement into investing in non - IT areas for VCs (bio tech, health care, travel and traditional industry) which has created new opportunities for investment. China's continued GDP growth means that the VC/PE market is still under-funded on a percentage basis as compared to more mature markets.” Zero2IPO’s *China Venture Capital Report Q1 2007* further supported Mr. Scown’s thoughts about VCs’ growing interest in non – IT industry by noting that “Bio/Healthcare and services accounted for 13.4% of all the VC deals respectively, the second largest percentage only after that for IT industry. ... Exits in Bio/Healthcare increased to 10.0% from 7.0% in the same period of 2006.”¹ Beyond the investment environment, some VCs based their strong confidence on their own investment team. For example, David Zhang of WI Harper Group offered that “I believe our team, plus WI Harper's investment strategy in China and long term experience will continue to position us well for future deal flow.”

Table 2

**Participating China based Venture Capitalists in the
2007 1st Quarter Confidence Index Survey**

Alicia Eastman	Asia Pacific Capital Group
Alvin Ho	CLSA Capital Partners
Cadol Cheung	Intel Capital Asia Pacific
David Zhang	WI Harper Group
George Li	China Merchants Group
Harry Man	WI Harper Group
Johannes Schoeter	Victoria Capital Limited
Marvin Lai*	iTM Ventures
Max Burger-Calderon	Apax Partners Ltd
Michael Scown	Intel Capital, Asia Pacific
Anonymous	
Anonymous	

*(Commentary used, but index rating not included as it arrived after the reporting period.)

Despite some VCs’ concerns of possible changes in the government policies and increased funds chasing good deals, many VCs remain generally optimistic. According to Zero2IPO’s *China Venture Capital Report Q1 2007* by Zero2IPO, in the first quarter of 2007, a total of 67 Chinese enterprises netted venture capital investments, among which 59 disclosed that they garnered a total of US\$419.00M. This compares favorably (a 25% increase) to US\$334.00M invested in the same period of last year. In addition, 69 deals were closed compared to 42 deals in Q1'06.² The healthy growth of the investment in start-ups and of the number of new deals indicates VCs’ confidence in the entrepreneurial ventures in China and their prudence in making investment decisions.

¹ Zero2IPO - China Venture Capital Report Q1 2007

² Zero2IPO - China Venture Capital Report Q1 2007

However, there was a 60% decrease in funds raised by VC firms.³ So while current venture deals are being financed at an increasing rate, future venture financings could be constrained from lack of new funds to VC firms. This situation suggests, as noted by some of our respondents, that the Chinese government macro policies may in fact be having a measurable impact on the venture industry and new firm financings in the near future. Specifically, uncertainty in Chinese macro policies and negative signals (e.g. rise in reserve requirements) could have a negative impact on the still emerging China venture capital industry. Still, a generally sound and encouraging macro economic and entrepreneurial environment coupled with the emerging investment opportunities in non-IT industries indicates continued health in high growth entrepreneurial activity and new company formation in the greater China region for the balance of 2007.

Mark V. Cannice, Ph.D. is an Associate Professor of Entrepreneurship and the Executive Director and Founder of the University of San Francisco Entrepreneurship Program (Cannice@usfca.edu). He has also been a Visiting Associate Professor with Peking University's Beijing International MBA Program (2005) and the Hong Kong University of Science and Technology School of Business (2005 - 2007). Ling Ding is a partner with MCLD Venture Resources and holds an MBA from the University of San Francisco (2006). The authors wish to thank the participating venture capitalists who generously provided their expert analysis and commentary. Please see the reports for the previous quarters at: www.EntrepreneurshipProgram.org under the publications tab. Venture capitalists who wish to participate in next quarter's Index survey are asked to contact Professor Mark Cannice at Cannice@usfca.edu. Webmasters are welcome to link to this report with courtesy notification to Cannice@usfca.edu. To post this report on your website, please request permission by email to Cannice@usfca.edu. When citing the index, please refer to it as: The China Venture Capitalist Confidence Index (Bloomberg ticker symbol: CVCCI), and include the associated Quarter/Year, and the full names and titles of the authors.

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³ Zero2IPO - China Venture Capital Report Q1 2007