

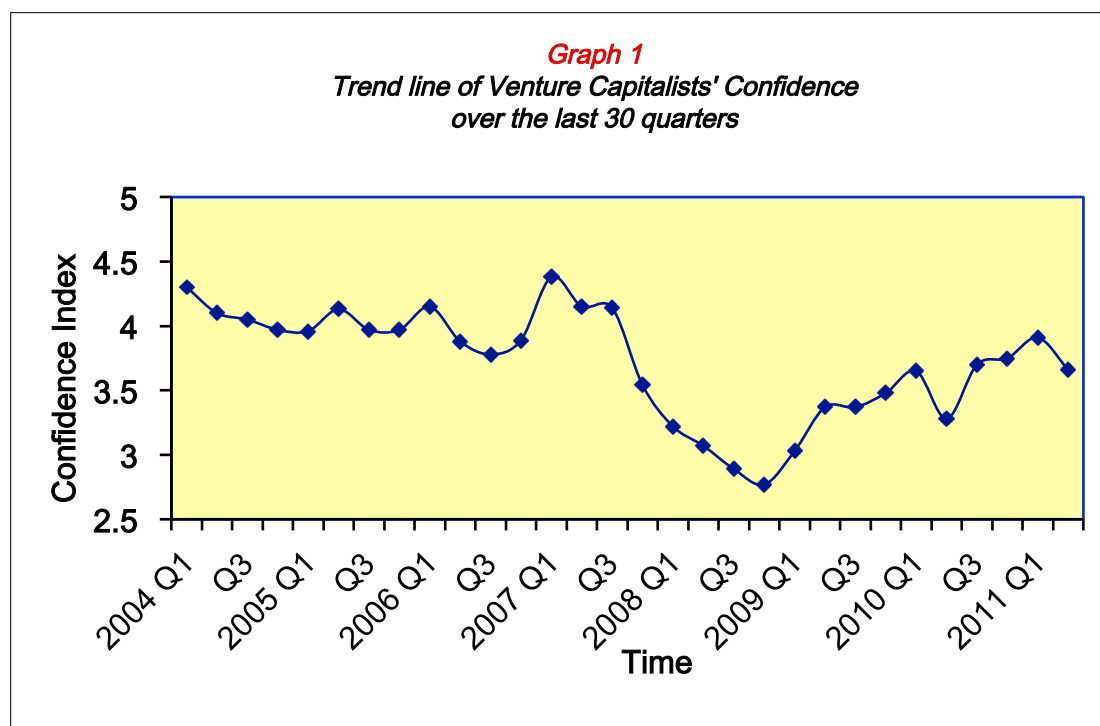
Silicon Valley Venture Capitalist Confidence Index®

(Bloomberg ticker symbol: SVVCCI)

Second Quarter – 2011
(Release date: July 29, 2011)

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The quarterly *Silicon Valley Venture Capitalist Confidence Index*® (Bloomberg ticker symbol: SVVCCI) is based on an on-going survey of San Francisco Bay Area/Silicon Valley venture capitalists. The *Index* measures and reports the opinions of professional venture capitalists in their estimation of the high-growth venture entrepreneurial environment in the San Francisco Bay Area over the next 6 - 18 months.¹ *The Silicon Valley Venture Capitalist Confidence Index*® for the second quarter of 2011, based on a June 2011 survey of 35 San Francisco Bay Area venture capitalists, registered **3.66** on a **5 point scale** (with 5 indicating high confidence and 1 indicating low confidence.) This quarter's index declined significantly from the previous quarter's reading of 3.91 indicating increased caution among the respondents to the Q2 survey. Please see Graph 1 for trend data.



¹ Publishing a recurring confidence index of professional venture capital investors is intended to provide an on-going leading indicator of the overall health of the high-growth new venture environment. Questions about this study or related issues should be addressed to its author at Cannice@usfca.edu.

The Silicon Valley Venture Capitalist Confidence Index® is sponsored in part by:



While many of the participating venture capitalists continued to be confident in the future prospects of the high-growth entrepreneurial environment, an increasing number found reason for caution due to worrisome macro economic trends, seemingly inflated valuations, uneven capital availability, and regulatory constraints in the life science arena. However, an underlying belief that the venture environment is still in an overall positive cycle, benefitting from opportunities created by technological trends in cloud and mobile computing and the continued growth of the social web, along with a supportive exit market, kept confidence from falling further. In the following, I provide many of the comments of the participating venture capitalist respondents along with my analysis. Additionally, all of the Index respondents' names and firms are listed in Table 1, save those who wished to remain anonymous.

The high-growth venture environment is improving, but in fits and starts with capital availability uneven across stages of investment. Bob Pavey of Morgenthaler Ventures explained “We are still in the early stages of an upturn...but there will continue to be many downs as well as ups. And some of the downs will be painful.” Similarly, Bob Ackerman of Allegis Capital contended that “The venture market is still regaining its footing.” Mr. Ackerman added that “A capital shortage in very early stage investing is overshadowed by exuberance in the social media sector. While disruptive innovation is alive and well many investors in venture capital funds are still on the sidelines. Capital inflows need to strengthen in the near term to restore overall balance. Liquidity is the key to re-starting the investment cycle on a broader basis.” Additionally, Joe Mandato of De Novo Ventures observed that “Funds are reluctant to commit to early stage deals and many are altering their investment objectives and are looking for later stage deals.” Another venture capitalist contributor who wished to remain anonymous warned of the “gap between seed stage investor valuation expectations and Series A VC investor valuation expectations.”

Concerns over “bubble-like” valuations were raised. One venture capitalist respondent who shared his comments in confidence, stated “2011 will be remembered as the year that everyone went nuts and overpaid -- \$1B is the new \$100M valuation. For most, this will end in tears.” Another VC respondent echoed this prediction, indicating that his sentiment was “high in areas like tech/consumer in the next 6-12 months until the bubble bursts...” Further, Chester Wang of Acorn Campus pointed out that the “Positive side is the ‘bubble-like’ IPOs by the Internet companies; the negative side is the worldwide economy, especially in China...”²

Some areas of life science are being hampered by the regulatory environment. Tom McKinley of Cardinal Ventures noted that the “...FDA is killing medical device companies with additional clinical trials and lack of clarity on the approval process.” Another contributor who wished to remain anonymous indicated his “concern is FDA and CMS.” And another anonymous VC contributor warned “For healthcare venture capital, obtaining FDA approval and obtaining reimbursement for new technologies is not getting any easier, nor do they look to improve significantly in the next 12-24 months.”

And broader economic conditions were a cause for concern. Kirk Westbrook of invencor detailed “Historically, since the Great Depression, each recession that saw financial institutions suffer, was followed by a protracted, slow overall economic recovery. Though there have been good corporate profits, the M&A activity does not appear to reflect their improved conditions. Despite a few high profile IPOs, there has not been a breadth sufficient to accelerate any sense of urgency. I believe that this tidal action of growth and retraction of the overall economy is reflected in the opportunity for entrepreneurs as well. It is very much a time of opportunity that is closely coupled with a need to be disciplined.” Another VC respondent who shared a comment in confidence also blamed “general economic conditions” for his low confidence in the venture environment.

² Confidence among venture capitalist in China is near a six-year low according to the *China Venture Capitalist Confidence Index* for Q2. Mark Cannice and Ling Ding.

Still – despite the concern over capital availability, valuations, macro economic issues and the regulatory environment for life science - industry and technological trends are supporting new venture development. Dino Vendetti of Formative Ventures indicated that “Strong growth in the web and mobile industries, the availability of seed capital, and the low cost of entry are continuing to drive new entrepreneurial activity.” In a similar vein, Tom Rodgers of Advanced Technology Ventures shared that “Optimism is high, particularly in the consumer Internet sector, and it is fueling a high level of startup activity and financing.” Bruce MacNaughton of Crosslink Capital noted that “Many companies are being formed, the Bay Area is the best entrepreneurial environment in the world, the proliferation of mobile devices is changing the world, and the economy is creating new opportunities.” And Jeb Miller of JAFCO Ventures pointed to an “Abundance of capital and robust market for startups in the mobile internet and cloud computing sectors.”

Venky Ganesan of Globespan Capital Partners reasoned “We are in the first innings of four major trends – cloud, mobile, social, and local. There are going to be some early homeruns (LinkedIn, Pandora, etc) and also some prominent strikeouts, but don’t let the strikeouts fake you. People often overestimate the impact of technology in the short run but underestimate its impact over the long run. These four horsemen of trends are going to result in one of the most productive periods of legal wealth creation in this country.” And Sandy Miller of Institutional Venture Partners observed “What is really exciting today is the convergence of the consumer and enterprise sectors. They are not separate silos anymore. They are very linked and this is fueling technology innovation.” Another VC respondent noted that “companies are meeting their numbers.”

An improved liquidity market is enhancing the VC business model. Deepak Kamra of Canaan Partners stated that “Despite recent volatility, the exit window is still open for M&A and IPO’s, and will probably be open for quality companies for some time.” And Dan Lankford of Wavepoint Ventures reported “Seeing more deal flow, and a somewhat better exit environment.” In fact, Thomson Reuters and the National Venture Capital Association reported that venture-backed IPOs had their best showing since Q3 2000.³ In line with this data, an anonymous contributor offered that “large tech companies are flush with cash and their board will put pressure on them to invest or pay dividends back. It should continue to accelerate the current M&A trend; the IPO market is still open.” And John Malloy of BlueRun Ventures tied his confidence to “Continued sector growth in mobile computing, and an improved IPO window... but has deep-rooted concerns about growth stage valuations.”

Igor Sil of Geneva Ventures explained his point of view on the venture capital exit market, stating “My confidence level in the current strength of the Venture Capital industry is high as a result of the key economic indicator for the industry, portfolio liquidity opportunities in both, the public markets and via M&A. The month’s strong IPO pipeline is due in part over the tremendous success of LinkedIn’s public market debut. LinkedIn shares skyrocketed to a high of \$92.99 per share, establishing a market value of \$8.9 billion. High valued pending IPO candidates include Facebook, Twitter, Groupon, Zynga, etc. The markets have reinvigorated investor confidence in venture backed companies back to the levels of 2004 when the biggest Internet IPO, Google, followed by Salesforce.com, debuted. This strong IPO pipeline in conjunction with Microsoft’s acquisition of Skype from PE firm Silver Lake Partners represents a significant liquidity window for Venture Capitalists. For venture backed late stage, high growth companies achieving profitability, the timing is optimal for realizing liquidity and venture investor returns. I expect the IPO market to remain vibrant through the remainder of the summer months and possibly into early fall. Late October, of course, is another matter.”

³ Thomson Reuters and NVCA Press Release July 1, 2011.

Positive momentum in the energy sector was emphasized. Bryant Tong of Nth Power shared “I see heightened activity and interest coming from the corporate sector in the energy sector. Energy management and control has shown both immediate and future benefits to a growing number of corporate entities. Government loans and grants were yesterday’s big news, today, corporate energy investment dollars are gaining traction and creating new opportunities and markets.” Furthermore, Alain Harrus of Crosslink Capital attributed his confidence to the “continued attractiveness of ‘everything software’, investments with high capital efficiencies, AND re-newed interest in energy tech investments.”

In the end, venture investments may be the best alternative. Dag Syrrist of Vision Capital reasoned that the “continued low interest environment, sluggish real-estate and increasing concern for inflation leaves venture and PE at least as an alternative for institutional capital seeking higher returns without the daily volatility seen in the public markets. This may also drive up investment rates - and valuations - to unrealistic levels, led by social media investments perhaps, but then again we're good at excess behavior. I think we're in for a good period, but it may be relatively short lived.” In fact, the venture industry enjoyed a 28% increase in committed funds in Q2 over the year earlier period, although the funding was concentrated among fewer firms.⁴

To sum, confidence in the high-growth venture environment fell during the second quarter due to concerns over macro economic trends, capital availability, and inflated valuations, as well as regulatory constraints in the life science area. However, a sense that we are still in a general upcycle in the venture environment enjoying positive technological trends and an improved liquidity environment persists. With an improving exit environment, greater capital commitments, and steady investments, the venture business model is working and supporting the creation of new innovative enterprises. A highly disciplined venture capital industry that is stressing viable business models in rapidly growing markets based on positive technology and social trends portends a healthy environment going forward. However, there is a risk that politically induced economic uncertainty in the U.S. and Europe could dry up liquidity in the financial markets and among corporate acquirers which could constrain the currently vibrant exit market. Barring another 2008 type meltdown in national or commercial financial markets, the steadily improving exit market that is welcoming new venture-backed issues will help ensure a continuing wave of innovation and new business development in the Silicon Valley and beyond. Whether the drop off in confidence in Q2 is a pause in the two-year upward trend in sentiment or a pivot toward lower confidence and harder times remains to be seen.

⁴ Thomson Reuters and NVCA press release, July 22, 2011.

Table 1

Participating Venture Capitalists in the 2011 2nd Quarter Confidence Index Survey

| Participant | Company |
|--------------------|--------------------------------|
| Alain Harrus | Crosslink Capital |
| Bill Byun | 7 Capital |
| Bob Bozeman | Eastlake Ventures |
| Bob Pavey | Morgenthaler Ventures |
| Brian Panoff | Granite Ventures |
| Bruce MacNaughton | Crosslink Capital |
| Bryant Tong | Nth Power |
| Dag Syrrist | Vision Capital |
| Dan Lankford | Wavepoint Ventures |
| Deepak Kamra | Canaan Partners |
| Dino Vendetti | Formative Ventures |
| Eric Buatois | Sofinnova Ventures |
| IDG Ventures | IDG Ventures |
| Igor Sill | Geneva Venture Management |
| Jeb Miller | Jafco Ventures |
| Joe Mandato | De Novo Ventures |
| John Malloy | BlueRun Ventures |
| Karan Mehandru | Trinity Ventures |
| Kirk Westbrook | invencor |
| Kristen Myers | Skyline Ventures |
| Robert Ackerman | Allegis Capital |
| Sandy Miller | Institutional Venture Partners |
| Shomit Ghose | Onset Ventures |
| Standish O'Grady | Granite Ventures |
| Stephen Harrick | Institutional Venture Partners |
| T. Chester Wang | Acorn Campus Ventures |
| Tim Chang | Norwest Venture Partners |
| Tom Baruch | CMEA |
| Tom McKinley | Cardinal Partners |
| Tom Rodgers | ATV Capital |
| Venky Ganesan | Globespan Capital Partners |
| Anonymous | Anonymous |
| Anonymous | Anonymous |
| Anonymous | Anonymous |
| Anonymous | Anonymous |

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