Silicon Valley Venture Capitalist Confidence Index®

(Bloomberg ticker symbol: SVVCCI)

First Quarter – 2011

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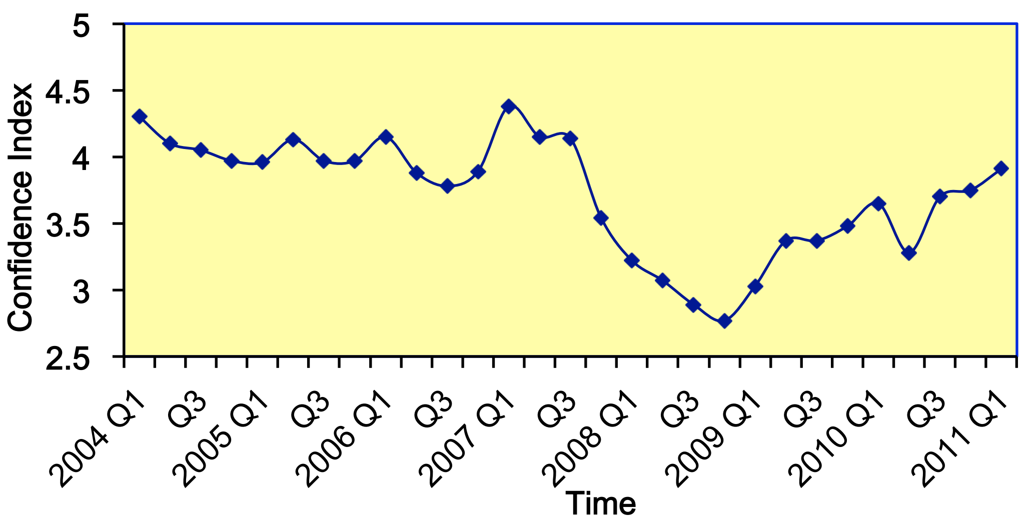
The quarterly *Silicon Valley Venture Capitalist Confidence Index® (Bloomberg ticker symbol: SVVCCI)* is based on an on-going survey of San Francisco Bay Area/Silicon Valley venture capitalists. The *Index* measures and reports the opinions of professional venture capitalists in their estimation of the 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 first quarter of 2011, based on a March 2011 survey of 33 San Francisco Bay Area venture capitalists, registered* ***3.91*** *on a* ***5 point scale*** (with 5 indicating high confidence and 1 indicating low confidence.) This quarter's index rose significantly from the previous quarter's reading of 3.75 indicating an increasing upward momentum in confidence since its low point in Q4 2008. Please see Graph 1 for trend data.

Graph 1

Trend line of Venture Capitalists' Confidence over the last 29 quarters



[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**.

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The steady rise in confidence among venture capitalists over the last two years gained momentum in the first quarter of 2011. While sentiment varied somewhat by sector, many respondents for the Q1 survey pointed to the exuberance in the social and mobile sectors. Upward trends in broad economic measures and public financial markets that are key to the venture industry also supported venture capitalists' confidence. Further, continued adoption by the enterprise and consumer of technologies being developed and enhanced by venture-backed firms (e.g. cloud, social, and mobile) suggests that the list of successful ventures focused on these markets is still growing. While concern remains over possible valuation bubbles in some spaces and an accompanying rush to join the party, overall confidence moved higher based on the improving metrics of the venture capital business model (e.g. fund-raising, investment, and liquidity.) 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.

Optimism is growing in fits and starts depending on the sector in question. Bill Reichert of Garage Technology Ventures penned "Venture capital has become a tale of two cities: It is the best of times, it is the worst of times, it is the age of wisdom, it is the age of foolishness …. or, possibly, three or four cities — consumer, enterprise, cleantech, biotech, etc. There is the consumer sector, which is thriving to the point of bubble-osity. And there is the rest of the entrepreneur ecosystem, which is either incredulous or envious of what's going on in social-mobile-gaming. Nevertheless, a rising tide is lifting all boats to varying degrees, and more capital seems to be coming back into the system, both at the bottom in the seed world and at the top from the institutional world. And from the corporate world, globally, there is a re-awakened interest in emerging innovations."

Dino Vendetti of Formative Partners echoed this sentiment, stating "The social and mobile web ecosystems are growing at a torrid pace. This, coupled with the increased availability of angel and early stage venture funding, are driving the creation of a huge number of start-ups in the Bay Area." A venture capitalist respondent who wished to remain anonymous affirmed that "The level of activity, especially in the software/internet/social media sector is almost frantic. This will continue for a while." A second anonymous venture respondent also reported seeing "a lot of activity in social media projects." Indeed, Dow Jones VentureSource reported a 35% increase in investment in U.S. venture-backed firms over the year earlier period.[2]

Noting that a new wave of growth is already upon us is Venky Ganesan of Globespan Capital who reasoned "The story of venture capital backed start-ups is too early, too early, too early, too early, too late!!! Well Ladies and Gentlemen, the time is now. We have a perfect storm of opportunity created by the intersection of major technology trends (cloud, mobile, social) and the best exit market in a decade. To paraphrase Shakespeare, there is a tide in the affairs of start-ups which taken at the flood leads to fortune. Carpe Diem." Also pointing to the positive trends is Steve Harrick of Institutional Venture Partners who contended that "Capital is readily available, people are feeling more confident and innovation continues. It is going to be a busy year."

Improving trends in the broader economy and financial markets are favoring VC investments. Kirk Westbrook of invencor explained "The entrepreneurial environment is reflective of the overall economy, some areas are more fertile and others much less so. I hear rumblings that there are increased inquiries into office space and it appears that after a protracted period there are some IPOs in process that may bring relief to the funding lifecycle that has been missing. The companies that do make it to the public altar will likely be watched closely, as their revenues and stability that have continued to build during this period would be expected to result in…stock prices that, at a minimum, hold steady. If this is not the

[2] Dow Jones VentureSource, Press Release, April 21, 2011.

case, I think it may bring about a dampening effect as the much needed end process of the funding cycle remains challenged. I am cautiously optimistic that the public markets will be accepting and there will be a resulting stimulative effect."

Dag Syrrist of Vision Capital reasoned that "The combination of exceptional public market returns over the last 18 months coupled with un-imaginable piles of corporate cash and the mind-numbing inability of institutions to actually make a forward-looking decision means that IPOs and growth-oriented PE/VC investments should benefit as a alternative for capital seeking beta returns." Meanwhile, Bob Bozeman of Eastlake Ventures noted that the "Overall economy is slowly improving - that does improve attitudes generally."

Improving financial markets are leading to more IPOs and strategic exits. Igor Sill of Geneva Venture Partners explained "IPOs and M&As are the lifeblood of our industry. Following the IPO freeze of 2009, things were reinvigorated with the 152 IPOs filed in 2010. That trend continues with 2011's pipeline, but I believe the true opportunities lie within the highly anticipated M&A side. Acquisitions of venture-backed companies in 2011 are on a record pace, providing liquidity and strong returns for venture investors. This activity, along with a slowly strengthening economy, should result in strong investor returns throughout 2011." Jeb Miller of JAFCO confirmed that this is a "Fantastic time to be an entrepreneur, plenty of available capital and a dramatically improving strategic exit environment." And Chester Wang of Acorn Campus Ventures observed "Better exit opportunities in both US and Asian markets."

Trends in technology innovation and adoption are also supporting the growth in venture opportunities. Sandy Miller of Institutional Venture Partners confirmed "While there are some signs of "froth," the scale, growth and quality of private technology/media companies is unprecedented." John Malloy of BlueRun Ventures indicated that "Silicon Valley is leading the mobile ecosystem globally." He continued, stating that this is "Really the first time this has happened in history of Industry. SmartPhones & tablets are leading-edge, driving technology adoption that will overtake PCs in 3-7 years." Further, Bruce MacNaughton of Crosslink Capital commented that "The penetration of mobile computing devices has reached a tipping point. This is opening new fault lines in the traditional landscape that are being exploited by new companies."

And Roy Thiele-Sardina of HighBar Partners offered that "The growth in SaaS and Cloud computing has made distribution and development of software less expensive and MORE and MORE start-ups are pursuing solving business problems (as opposed to consumer problems) in those environments."

Entrepreneurs necessarily became stronger and more diligent during the broader economic downturn and now are more able to take advantage of the upturn. Graham Burnette of Red Planet Capital observed that "Entrepreneurial activity did not slow during the recession. If anything, it accelerated. Significant companies that were doing well (Google, facebook, Apple...) were able to be very selective in their hiring and become even more focused on excellence than they were before. New start-ups are similarly populated with brilliant thinkers. We see a stream of exciting companies currently in the development stage, which will soon result in announcements of new products and profits realized on past investments - which always leads to new investments. The only major concern I have right now is whether we might slip into another bubble of unsustainable valuations."

However, concerns over the sustainability of the venture capital business model were raised. Bob Ackerman of Allegis Capital indicated that "Venture Capitalists have invested almost $15B more than they have raised over the past three years. This trend is not sustainable and will have negative impact on the ability of start-ups to raise capital if it is not reversed. When combined with intensive competition for engineering resources, there are some significant challenges in moving entrepreneurial innovation from concept to implementation." Another respondent who wished to remain anonymous pointed to an "Improving climate for follow-on venture financings, but continued limited exit options." In fact, Dow Jones VentureSource reported a decline in the number of U.S.-based venture-backed companies achieving liquidity in the first quarter of 2011, although the total capital raised showed an increase from the year earlier.[3] In this case, it appears that increased valuations of venture-backed firms are reinforcing the line between the haves and have-nots of venture portfolio firms.

Caution has not disappeared. Debra Beresini of invencor observed that "There seems to be a steady stream of investing these days, but most funds are still being cautious." Another venture respondent who responded in confidence relayed "The overall economy and financial markets are gaining steam and stability, but I am concerned about over-heating in certain technology sub-sectors. Anecdotally, valuations seem quite high, term sheets are dropping ahead of diligence, and there are overabundances of competing start-ups and pools of available capital. In contrast to the Bubble period, I think there are often real businesses and profits at the center of these sectors, but I am concerned about the valuations and competitive dynamics. Additionally, I am worried about the rise of secondary markets and transactions in illiquid private companies. I find the information asymmetry and potential for misaligned employee/shareholder incentives troubling. On the positive side, as hot as some sectors are at the moment, there are other sectors that are so totally out of favor that I suspect they will generate outstanding returns in the coming years."

And some sectors are lagging. Joe Mandato of De Novo Ventures indicated that "We are not of the woods yet in terms of enthusiasm and excitement in life science opportunities. Certain segments such as spine or other long regulatory-cycle specialties continue to face a slow financing process."

The upward trend in confidence among the responding venture capitalists to this quarterly survey accelerated in Q1. Growing enthusiasm in the social and mobile space is cheering venture financiers, and LP support appears to be returning. While valuations in the social media sector may be ahead of themselves, they are helping drive venture pricing higher in other sectors, and the result is increased enthusiasm among most market participants. Generally improving exit opportunities are also supporting the venture business model and bolstering confidence. Whether rapidly ballooning valuations are making corporate acquirers more cautious or greater availability of initial public offerings are crowding out some acquisitions, the trend of strategic exits overshadowing IPOs slowed somewhat in Q1. Whether this is a momentary adjustment or the manifestation of increased entrepreneurial and venture capitalist confidence that is prodding them to await independent liquidity and higher returns is yet to be determined. Still, the large increase in the amount of fundraising in Q1 2011 from a year earlier[4] points to a rise in confidence, capability, and perhaps patience of the limited partners who provide the fuel to the innovation machine of Silicon Valley.

The trend of increasing IPO exits, increasing LP funding, higher valuations and increasing venture investment, along with increasing VC confidence points to a healthy venture capital business model and portends an exciting year in the venture world. These positive trends will end eventually, but not this year.

[3] Dow Jones VentureSource, Press Release, April 1, 2011.
[4] Thomson Reuters and National Venture Capital Association, April 22, 2011

Table 1

Participating Venture Capitalists in the 2011 1st Quarter Confidence Index Survey

Participant	**Company**
Alain Harrus	Crosslink Capital
Bill Byun	7 Capital
Bill Reichert	Garage Technology Ventures
Bob Bozeman	Eastlake Ventures
Bob Pavey	Morgenthaler Ventures
Brian Panoff	Granite Ventures
Bruce MacNaughton	Crosslink Capital
Dag Syrrist	Vision Capital
Dan Lankford	Wavepoint Ventures
Debra Beresini	invencor
Deepak Kamra	Canaan Partners
Dino Vendetti	Formative Ventures
Eric Buatois	Sofinnova Ventures
Graham Burnette	Red Planet Capital
IDG Ventures	IDG Ventures
Igor Sill	Geneva Venture Management
Jeb Miller	Jafco Ventures
Joe Mandato	De Novo Ventures
John Malloy	BlueRun Ventures
Kirk Westbrook	invencor
Robert Ackerman	Allegis Capital
Roy Thiele-Sardina	HighBAR Partners
Sandy Miller	Institutional Venture Partners
Shomit Ghose	Onset Ventures
Standish O'Grady	Granite Ventures
Stephen Harrick	Institutional Venture Partners
Steve Sullivan	Skyline Ventures
T. Chester Wang	Acorn Campus Ventures
Tom McKinley	Cardinal Partners
Venky Ganesan	Globespan Capital Partners
Anonymous	Anonymous
Anonymous	Anonymous
Anonymous	Anonymous

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