Silicon Valley Venture Capitalist Confidence Index®

(Bloomberg ticker symbol: SVVCCI)

Second Quarter – 2015

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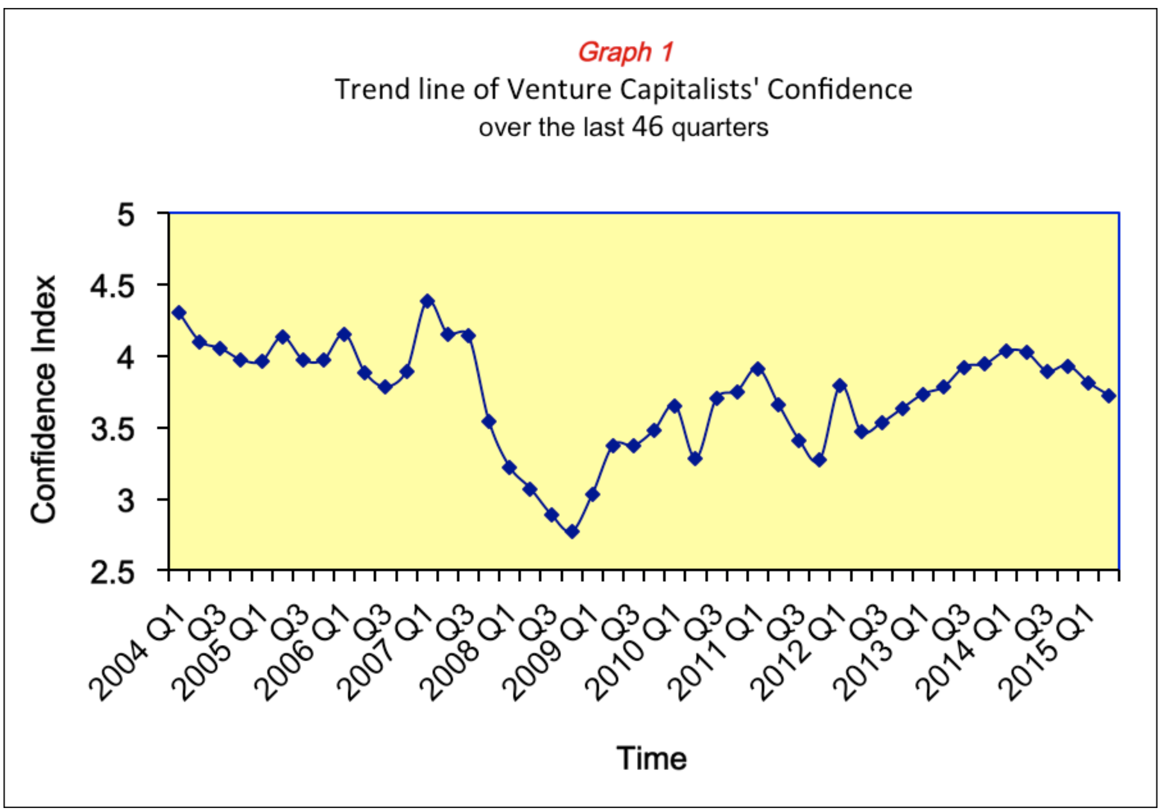
The *Silicon Valley Venture Capitalist Confidence Index® (Bloomberg ticker symbol: SVVCCI)* is based on a recurring quarterly survey of San Francisco Bay Area/Silicon Valley venture capitalists. The *Index* measures and reports the opinions of professional venture capitalists on their estimations of 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 2015, based on a June 2015 survey of 28 San Francisco Bay Area venture capitalists, registered 3.73* ***on a 5 point scale*** (with 5 indicating high confidence and 1 indicating low confidence). This quarter's index measurement declined from the previous quarter's index reading of 3.81. Please see Graph 1 for trend data.



[1]Questions about this ongoing research study or related topics should be sent to Professor Mark Cannice at **Cannice@usfca.edu**.

Overall confidence declined again among the responding Silicon Valley venture capitalists in the second quarter of 2015. While an expectation of a continued strong exit market – both IPOs and M&As - for venture-backed firms remained, along with an abiding confidence in the Silicon Valley ecosystem for new venture creation, increasing concern about high valuations of venture-baked firms restrained sentiment. Uncertainty over the entry of new types of investors, the rising cost of doing business in Silicon Valley, and the potential fallout of macro environment issues (e.g. China, E.U.) also gave pause to some venture investors.

The modest decline in confidence came amidst strong industry metrics in VC fundraising and investments, and exits of venture-backed firms. For example, the NVCA and Thomson Reuters reported the highest level of venture capital fund-raising since 2007.[2] Of course, the greater supply of funds available also makes possible the higher levels of valuations that give some venture capitalists pause. The NVCA and PWC also reported the highest level of venture investments since Q4 2000.[3] This wave of capital being put to work will certainly nourish new venture creation and innovation while also providing the demand that drives up valuations for the most promising projects. IPO activity for venture-backed firms in Q2 also increased significantly from the previous quarter but was down from the year earlier quarter[4], signaling a healthy exit environment but one that is not operating at the same pace of VC fund-raising and investments.

Despite the overall strong venture business model metrics, the *Silicon Valley Venture Capitalist Confidence Index* edged lower in Q2 as it matched its 11-year average of 3.73, its lowest point in two years. As VC confidence tends to be forward-looking[5], this disparity is not unusual, but suggests that additional consideration of potential future trends is warranted. 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 provided their comments confidentially.

Expectations that a continuing strong IPO and acquisition market for venture-backed firms will continue to drive up valuations encouraged some of the venture capitalists responding to the Q2 survey. For instance, Igor M. Sill of Geneva Venture Management stated "I sense that continued new IPO activity and cash-rich treasuries at Amazon, Apple, Cisco, eBay, EMC, HP, Microsoft, Oracle, Salesforce will yield high valuation acquisitions of venture-backed startups. Shareholders are embracing acquisitions that promise greater market share and growth opportunities. Surprisingly, the stock prices of the acquiring companies have tended to appreciate even higher with smart acquisitions as evidenced by the volume of global M&A which surged to $2 trillion for the year. The robust rebound of the US economy gives me confidence that the recovery will continue to lift venture's positive momentum."

Similarly, Sandy Miller of Institutional Venture Partners commented "After a surprisingly slow start, the IPO market for venture-backed tech companies has begun to accelerate. I think 2015 will finish strong and carry over in 2016." Mr. Miller added "There are some amazing companies that have filed confidentially." And Dixon Doll of DCM pointed to "widely available capital, attractive valuations for companies and teams, and a strongly positive liquidity environment" for his confidence while also noting a "frothy valuation environment." Crediting macro-economic drivers, Tim Draper of DFJ reasoned "Low interest rates bring on high stock prices which lead to more wealthy people investing and more companies wanting to buy start-ups."

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[2] NVCA and Thomson Reuters press release dated July 8, 2015.

[3] NVCA and PWC press release dated July 17, 2015 (based on MoneyTree™ Report, Data: Thomson Reuters).

[4] NVCA and Thomson Reuters press release dated July 2, 2015.

[5] Cannice, Mark V., and Cathy Goldberg (2009). "Venture Capitalists' Confidence, Asymmetric Information, and Liquidity Events", *Journal of Small Business and Entrepreneurship* (Routledge) 22 (2), pp. 141-164.

In addition to a strong exit environment, other fundamental trends are supporting the current venture environment. Providing a detailed analysis, Paul Holland of Foundation Capital wrote "I have high confidence in continued growth in the venture entrepreneurial environment for three reasons.
1) For the first time in the history of Silicon Valley, the largest sources of growth are coming from entrepreneurs *disrupting* existing businesses (transportation, finance, food, media) versus creating new industries like lasers and semiconductors. These existing markets are several orders of magnitude larger than the original markets that formed the basis of growth in the early Silicon Valley. (See the documentary, 'Something Ventured', for more insight here.)
2) Upstream sources of funding (endowments, pensions, etc.) are flowing into large scale private companies at a record pace, providing ample resources for growth and product line as well as geographic extensions.
3) More and more extremely talented young people are forgoing jobs in large companies in favor of starting new businesses at a pace and scale unheard of in the history of the Silicon Valley. The stage is set for the continuation of one of the longest sustained periods of expansion in the Valley's history."

Emphasizing a portfolio approach to venture opportunities, Eric Buatois of Benhamou Global Ventures observed that "Innovation is very healthy in a lot of different sectors: biotech, cloud computing, cyber security, robotic, SAAS applications, Internet. If one sector cools down, the other sectors will remain very healthy given the loose correlation between customers and corporate investors across sectors." To this point, in the life science arena, Tom McKinley of Cardinal Partners attributed his confidence to the fact that "digital health is coming of age" as well as recent life science exits like the Teledoc IPO. In fact, life science companies accounted for the majority of venture-backed IPOs in Q2.[6]

Some venture capitalist respondents tempered their optimism, noting high valuations and some macro risks to the on-going momentum. For example, Venky Ganesan of Menlo Ventures explained "The perfect storm of mobile, social and cloud still remains strong and augers well for the health of the tech eco-system long-term. Both seed stage and late stage venture is experiencing frothiness as the tourists have arrived and they are paying prices that the locals won't. I expect a correction in the near term especially when the Fed raises interest rates, but the long-term picture remains very strong. Its not software but rather Silicon Valley that is eating the world." Additionally, John Malloy of BlueRun Ventures contended "The entrepreneurial fabric of Silicon Valley as the leading Technology Innovation Center worldwide remains strong." Mr. Malloy continued, noting, however, some concern over valuation, primarily in the late stages of private equity that will eventually cause a drop in available financing overall. And Gerard van Hamel Platerink of Redmile Group maintained "There has rarely been a better time to raise money for private companies with the right profile. Deals are getting done quickly by a wide variety of investors, some quite new to the venture arena. Time will tell whether or not the deals done in 2015 will make investors the returns that they require to raise their next fund."

Pointing to macro and public market risks, Bill Reichert of Garage Technology Ventures offered "I think the opportunities for innovation are better than ever, but the macro economy is looking more fragile these days, with Europe and China both signaling that all is not rosy. As much as we might wish otherwise, if the public markets retreat, it will hurt us. Time to make sure you have plenty of runway!" In fact, one other VC contributor blamed the "sluggish IPO market" for low confidence this quarter.

Citing local ecosystem constraints, Bob Bozeman of Eastlake Ventures relayed "The priciness of opportunities seems to have slowed its ramp and the IPO queue seems prepared to provide some wins; however, talent competition and costs for doing business in Silicon Valley are continuing to push up the

[6] NVCA and Thomson Reuters press release dated July 2, 2015.

amount of investment required to successfully compete in Silicon Valley." Meanwhile, Bob Ackerman of Allegis Capital shared "The unprecedented fund raising and valuations associated with so called 'Unicorns' and the knock-on effects for the venture ecosystem in terms of broader market expectations around valuations, compensation, and all aspects of the costs of doing business for venture companies gives reason for substantial pause. Expectations are beginning to outpace reality." Likewise, a VC respondent who requested anonymity noted "The overall environment for innovation and growth remains positive - with downsides being the high cost of doing business in the Bay Area and inflated private valuations at all stages."

Observing these trends, Dag Syrrist of Vision Capital concluded "The range of sectors in the economy that represents significant opportunities for improvements, whether from a cost, service or innovation standpoint has dramatically expanded as computing, storage and customer acquisition costs have come down. That said, not sure adding 'tech' to any area makes it venture financeable, but what's more puzzling is how fewer start-ups are actually tackling hard problems with actual innovation and technology. Competing on round size and valuation metrics with no intrinsic value (other than intermediate LP reporting -- also is of little intrinsic value come to think of it) will by definition end badly for many if not most. Hard to tell what the early indicators of that will be; I for one would have predicted this cycle to have turned by now especially as existence cost in the Bay Area is making it fantastically expensive to hire and retain folks. But like that other thing, I'll know it when I see it."

In sum, average confidence declined among the responding venture capitalists for Q2. This is the second consecutive quarterly decline in the confidence index and its lowest level in two years. While confidence in the underlying strength of the Silicon Valley ecosystem and its entrepreneurs' innovative capacity and determination remained, worries about hefty valuations, the increasing costs of doing business, new demand/supply dynamics created by new venture investor categories, and the potential impact that macro issues may have on the venture environment tempered sentiment.

Overall metrics of the venture business model reached historic levels (e.g. fund-raising and investments) in the second quarter, but a number of venture capitalists in this survey focused on the sustainability of these trends and their relationship to exit prospects and ROI given increasing valuations. In fact, the very strong venture metrics of fundraising and investments in Q2 may, in part, be driving valuations to points that concern some venture investors. While the powerful ecosystem in Silicon Valley for venture creation, innovation, and long-term value creation continues to grow stronger, short to medium-term prospects for positive investment results appear somewhat less certain.

Table 1

Participating Venture Capitalists in the 2015 2nd Quarter Confidence Index Survey

Participant	**Company**
Bill Byun	7 Capital
Bill Reichert	Garage Technology Ventures
Bob Bozeman	Eastlake Ventures
Dag Syrrist	Vision Capital
Dan Lankford	Wavepoint Ventures
Deepak Kamra	Canaan Partners
Dixon Doll	DCM
Eric Buatois	Benhamou Global Ventures
Gerard van Hamel Platerink	Redmile Group

Igor M. Sill	Geneva Venture Management
Jack Young	Qualcomm Ventures
Jeb Miller	Icon Ventures
John Malloy	BlueRun Ventures
Jon Soberg	Expansive Ventures
Karan Mehandru	Trinity Ventures
Paul Holland	Foundation Capital
Robert R. Ackerman, Jr.	Allegis Capital
Sandy Miller	Institutional Venture Partners
Shomit Ghose	Onset Ventures
Standish O'Grady	Granite Ventures
Stephen J. Harrick	Institutional Venture Partners
Tim Draper	DFJ
Tom McKinley	Cardinal Partners
Venky Ganesan	Menlo Ventures
Anonymous	Anonymous
Anonymous	Anonymous
Anonymous	Anonymous
Anonymous	Anonymous

Mark V. Cannice, Ph.D. is Department Chair and Professor of Entrepreneurship and Innovation with the University of San Francisco School of Management. The author wishes to thank the participating venture capitalists who generously provided their expert commentary. Thanks also to Jack Cannice and James Cannice for their copy-edit assistance. When citing the index, please refer to it as: *The Silicon Valley Venture Capitalist Confidence Index®*, and include the associated Quarter/Year, as well as the name and title of the author.