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VENTURE CAPITALISTS BULLISH ON 2007

NVCA Annual Predictions Survey Shows Strong Interest in Energy, New Media and Alternative Exit Strategies

December 18, 2006, Washington, D.C. – Venture capitalists are predicting a strong and stable investment climate in 2007 with opportunities across a diverse group of industry sectors and global regions, according to a survey conducted by the National Venture Capital Association (NVCA). And while there is dissension as to whether the IPO market will open for venture-backed companies in 2007, there are strong indications that the venture capital community will be betting on alternative exit strategies for their portfolio companies in the coming year. The survey results also suggest that there will be fewer venture funds operating in 2007 as the technology bubble burst finally works its way through the system.

“Alternatives will drive venture capitalists in 2007,” said Mark Heesen, president of the NVCA. “This industry has built itself on finding alternative approaches to existing infrastructure issues. The 2006 investment momentum in sectors in need of or receptive to such changes, including energy, Internet and media/entertainment, will accelerate next year. Additionally, if the venture-backed IPO market in the U.S. doesn’t begin to open in 2007, the VC industry will begin to leverage alternative markets and buyers for their portfolio companies. An industry-wide shift toward these new exits has the potential to fundamentally transform the venture capital business model.”

The NVCA survey was conducted in early December and includes the predictions of more than 200 venture capitalists from across the United States.

Venture Investment

With 69 percent of venture capitalists predicting investment levels between \$20-29 billion in 2007, most respondents believe the RIPE (Rational Investable Performance-driven Equilibrium) zone is sustainable. However, one-third of respondents project higher levels of investment (\$30-\$39 billion) for the coming year. The average total 2007 investment level prediction was \$27.6 billion.

Venture capitalists are also predicting greater deal flow activity overseas. Not surprisingly, the areas of greatest interest are China and India with an overwhelming 93 percent and 92 percent of respondents forecasting increases in investment in these respective regions. Other global regions where VCs are predicting increases are Eastern Europe (59 percent) and other Asian countries (61 percent). The areas where the most VCs are predicting investment declines include Israel (15 percent of respondents forecasted investment decline there), Canada (13 percent) and Western Europe (13 percent).

The momentum in energy investing is expected to continue to 2007 with 91 percent of all VCs expecting increases in the sector next year. Based on the survey, companies operating at the intersection of Internet

and media are also poised for more VC investment. According to the results, 70 percent of the VCs see increases in Internet specific companies; 69 percent see increases in media and entertainment investing. Areas of lower growth include semiconductors and software where only 9 percent and 23 percent of the respondents are predicting growth respectively.

The survey found that most VCs expect to see increased competition from other alternative asset classes in 2007 with 62 percent saying the venture capital industry will more intensely compete with hedge funds for deals and 48 percent believing there will be more competition from buyout firms.

Venture Exits – IPOS and M&As

With regard to the public markets as a viable exit strategy, VCs are sharply divided with 47 percent of respondents predicting that the U.S. IPO market will remain sluggish and 50 percent expecting to see signs of recovery in 2007. Only 3 percent expect a strong IPO recovery next year.

Mergers and acquisitions are predicted to deliver returns in 2007 with more than three-quarters of respondents (78 percent) saying M&A deals will be the exit of choice and only 22 percent forecasting a decrease from 2006 levels.

Alternatives to the traditional VC exit routes are expected to be a prevalent factor in 2007. More than half of VCs surveyed (57 percent) believe there will be a greater propensity for U.S. venture-backed companies to consider overseas IPOs next year. More interesting perhaps is the fact that 71 percent of the venture capitalists surveyed believe the purchase of portfolio companies by private equity firms will become a more attractive option in 2007.

Venture Fundraising

The survey found that there will be no shortage of investable capital over the next several years with 79 percent of respondents predicting that venture firms will raise similar size or larger funds during the next fundraising cycle. However, half of the respondents predict fewer firms will be doing deals after the next fundraising cycle with 48 percent forecasting a decrease in the number of venture firms operating in the U.S.

“Limited partners are going to become increasingly discerning in 2007 as the final performance of the 1998-2001 funds become clear,” remarked Heesen. “As part of the natural selection of the venture capital process, some firms may indeed find themselves in a position where they will not be able to raise a follow-on fund. The pundits were correct about the reduction in venture capital firms – they were just a few years too early and a few firms too many.”

While most VCs (58 percent) expect the time between funds raised to be consistent with historical norms at 3-4 years, thirty eight percent of the respondents believe that firms will go out faster, raising follow-on funds in less than three years from the last fund close.

More than 90 percent of the VC respondents indicated a shift in the demographics of future funds raised. When asked to describe the make-up of the next fund cycle, 47 percent of respondents predict there will be less brand name firms operating; 43 percent say the number of industry focused funds will increase; and 42 percent predict an increase in emerging funds.

Venture Capital Performance

When asked how well short-term (3-5 year) venture performance will fare in 2007, a majority of respondents (56 percent) predicted improvement. Venture capitalists are evenly divided in projecting the performance of long-term (10-20 years) returns, with 41 percent saying there will be no change, 32 predicting improved returns, and 27 percent predicting a decline in long term performance. Eighty percent of respondents believe the asset class will continue to outperform the public markets in 2007.

For survey highlights and a compilation of NVCA member predictions on exits, investments and other venture-related forecasts, please contact Emily Mendell at emendell@nvca.org.

The National Venture Capital Association (NVCA) represents approximately 460 venture capital and private equity firms. NVCA's mission is to foster greater understanding of the importance of venture capital to the U.S. economy, and support entrepreneurial activity and innovation. According to a 2004 Global Insight study, venture-backed companies accounted for 10.1 million jobs and \$1.8 trillion in revenue in the United States in 2003. The NVCA represents the public policy interests of the venture capital community, strives to maintain high professional standards, provides reliable industry data, sponsors professional development, and facilitates interaction among its members. For more information about the NVCA, please visit www.nvca.org.