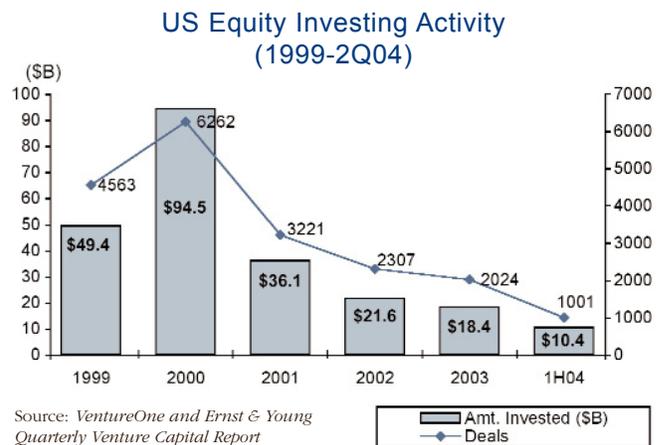
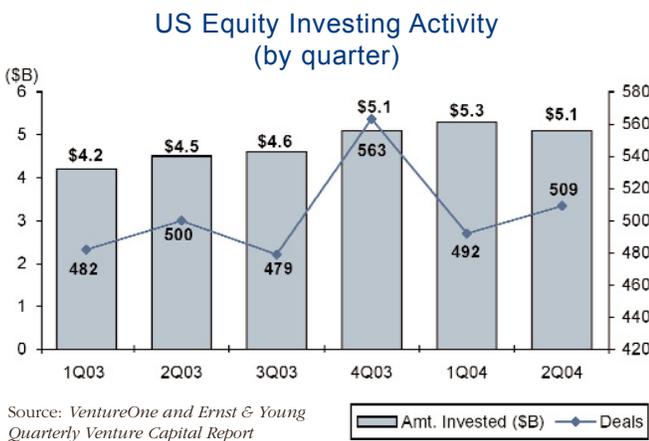


Venture Capital Update Q2 2004

At Silicon Valley Bank, understanding the industries we serve is fundamental. Like you, we track, study and analyze the activity in our markets and, as your partner, we want to share our findings. This report chronicles venture capital activity in Q2 2004 and includes commentary from our vantage point in the industry regarding what it all means. We seek out and consolidate the most compelling data, pointing to the trends in the technology and life science industries. We invite your opinions and encourage ongoing dialogue regarding the opportunities ahead of us.



GPs and LPs Unite

By Doug Hamilton and Brian Rodde, SVB Capital

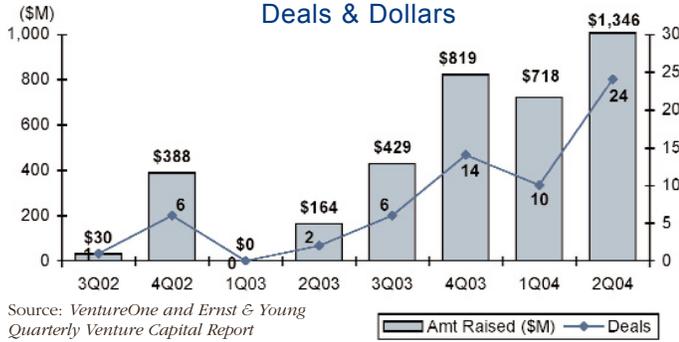
Differing viewpoints between general partners and limited partners are part of the fabric of venture capital, and the current overcapitalization of the industry amply illustrates the difference in perspective between the two. While GPs remain cautious about making investments in an industry that is still in recovery mode, LPs' appetites for private equity, especially early-stage venture capital, have returned in full force after several lean years.

None of this is surprising. What is surprising is the apparent alignment of GPs and LPs over the need in today's environment to expand their horizons to new industries and geographies, and the importance of allying themselves with the right people in these unknown territories.

Too Much of A Good Thing

Let's start with overcapitalization. In the current environment, firms boasting over-subscribed funds have become commonplace. One reason may be the high caliber of the firms that have recently raised funds, including Charles River Ventures, Doll Capital Management, Kleiner Perkins Caufield & Byers, Oak Investment Partners, Sevin Rosen Funds and Technology Crossover Ventures. However, over-subscription has not been limited to a few select firms. Many less well-known funds have also met and exceeded their targeted fund sizes. These firms might have had

US Venture-Backed IPOs Deals & Dollars



Region Focus All Industries

	# of Deals	# Invest. firms	Avg. Per Deal	Sum Inv. (\$M)	% of Invest.
Bay Area	154	365	\$12.5	\$1,874.0	36.6%
Midwest	11	24	\$7.0	\$78.3	1.5%
New England	74	190	\$11.8	\$833.2	16.3%
New York Metro	35	85	\$10.8	\$389.1	7.6%
Texas	33	106	\$10.3	\$320.4	6.3%
Potomac	14	45	\$6.7	\$95.5	1.9%
Southeast	26	68	\$9.2	\$232.7	4.5%
Orange County	10	23	\$6.3	\$67.2	1.3%
Los Angeles	15	32	\$8.8	\$122.5	2.4%
San Diego	12	63	\$13.6	\$175.2	3.4%
Oregon	10	20	\$7.9	\$71.2	1.4%
Philadelphia	10	28	\$10.7	\$117.5	2.3%
Colorado	7	22	\$11.1	\$71.4	1.4%
Washington State	21	68	\$14.8	\$271.7	5.3%
Southwest	10	29	\$9.3	\$88.7	1.7%
Research Triangle	5	8	\$4.9	\$24.3	0.5%
Total	509	877	\$10.6	\$5,126.0	

Source: VentureOne/Ernst & Young

Post Money Valuation Report (\$M) - 2Q04

Biopharmaceuticals	\$56.0
Healthcare Services*	NS
Medical Devices	\$26.0
Medical Information Systems	\$21.1
Communications & Networking	\$40.0
Electronics & Computer Hardware	\$35.0
Information Services*	NS
Semiconductors	\$30.0
Software	\$20.3
Consumer & Business Products	\$10.9
Consumer & Business Services	\$19.8
Retailers*	NS

*Four observations needed for valuation

Source: VentureOne

a challenge raising funds were it not for salivating LPs anxious to put money to work in an industry that presented few fund investment opportunities from 2000 to 2003.

Tench Coxe of Sutter Hill Ventures also points to the continued low interest rate environment as a factor contributing to the over funding of the asset class. Coxe believes that low interest rates make public equity less attractive than private equity, stating, "Once interest rates rise, LPs will become more responsible in determining where to put their money." Rising interest rates may also spur the long-anticipated venture industry shakeout, in which fewer firms and funds will exist.

Paradoxically, the excess capital flooding the industry has benefited those companies with established financing, more than those without. According to Raman Khanna, general partner at Diamondhead Ventures, there is relatively little interest in seed and series A financings in today's environment, while series B financings tend to be highly competitive. Khanna echoes industry sentiment by proclaiming, "Risk-adjusted, series B financings are becoming the most expensive."

New Innovation Versus New Markets

With more money coming into the industry, VCs are trying hard to find differentiated deal flow. This search has spawned the alignment between GPs and LPs as discussed above, although opinions vary among VCs regarding where investment opportunities will be found. Khanna, for one, believes that cross-disciplinary research going on at many universities will yield truly innovative investment opportunities. For example, materials science and electrical engineering is a promising combination.

Coxe, meanwhile, is focused on "finding old and arcane industries and applying new technologies." One example he cites is Lynk Systems, a credit card transaction firm and Sutter Hill Ventures portfolio company. Lynk Systems was recently acquired by Royal Bank of Scotland for \$525 million.

A reluctance to invest in industries crowded by startups, as well as the maturation of foreign markets, has led many GPs and LPs to head overseas in search of new investments. So far, many of the investments made overseas seem to be financing incrementally more efficient business models, rather than developing truly unique technologies. Coxe agrees, and adds a word of caution, "Most of the deals being done overseas employ business models that make their companies simply bigger, faster and cheaper than competitors. However, these companies are bigger, faster and cheaper on every dimension and you can not ignore them as investment opportunities."

Some VCs predict that India and China are poised to begin developing novel technologies, and equate the current environments in those countries to that of Israel ten years ago. Khanna suggests a reason for this optimism: "India has always had a talented pool of engineers. What has been missing is the cultural shift necessary to foster innovation. That shift is beginning to take place as the stigma of failure starts to disappear in India." Despite Khanna's assertion that international investment opportunities will become more prevalent, and the fact that all of his software companies have employees in India, he is quick to add, "Silicon Valley remains the center of innovation. I still prefer to invest in seasoned Valley executives rather than unproven Indian entrepreneurs."

IPO Window: Half Open or Half Shut?

On the liquidity front, both the number and size of M&A deals appear to have steadied (see chart US VC-Backed M&A Activity, 2002-2Q04, this page). This could be a result of acquiring companies having satisfied their pent-up need for startup companies. More likely, startup companies are holding out for what they believe to be a more profitable and more visible form of exit – an IPO.

Over the past quarter there has been a marked increase in the number of venture-backed IPOs (see chart US Venture-Backed IPOs Deals & Dollars, page 2). Some prognosticators have declared the "return of the Valley," proclaiming that public markets are hungry for issues that meet the "IPO hurdle." While there has certainly been an increase in the number of IPOs, the quality of these issues is coming into question. As Jake Reynolds of Technology Crossover Ventures (TCV) reports, "The quality of companies on file [for IPO] is lower than it was a year ago." He notes that the average quarterly revenue and profitability of companies filing for IPOs is significantly below what it was a year ago. TCV statistics show that all of July's tech IPOs were priced below the midpoint of their S-1 filing ranges and the average S-1 filing price-to-IPO offering price dropped 14.5%. TCV's numbers also show that the median performance for July's tech IPOs decreased 4.0% from the IPO price.

The underperformance of new issues, combined with regulatory concerns, could contribute to a decrease in companies attempting IPOs. Reynolds states, "The regulation and cost of being a public company are weighing heavily on the minds of startup CEOs." Similarly, Coxe suggests, "Unless your portfolio companies need the capital, it might be better to wait a year and have Sarbanes-Oxley settle down before attempting an IPO. At that point accounting firms and regulators will have a better understanding of what Sarbanes-Oxley requires."

In general, both GPs and LPs these days are feeling a mix of relief, optimism and frustration: relief because of the increased number of liquidity events that their portfolio

Most Active Investors - 2Q04

Firm Name	Under Mgmt (\$M)	# of Deals in 2004
New Enterprise Associates	5,000	13
Venrock Associates	2,000	11
U.S. Venture Partners	3,200	10
Intel Capital*	750	8
Oak Investment Partners	4,186	8
Benchmark Capital	2,830	7
Austin Ventures	3,101	7
Mayfield	2,400	6
Canaan Partners	2,000	6
Crosslink Capital	1,040	5

* Corporate VC

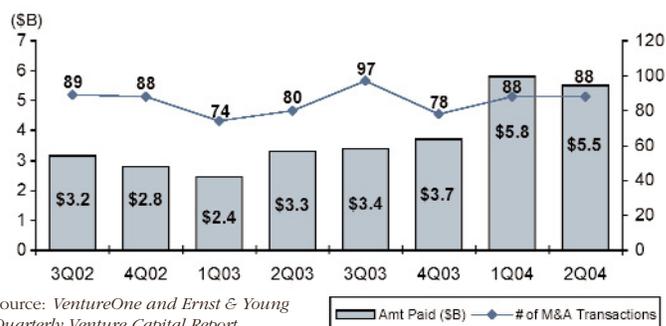
Source: VentureOne and Ernst & Young Quarterly Venture Capital Report

US VC-Backed Liquidity Events by Industry 2002-2Q04

	2002		2003		1H04	
	IPO	M&A	IPO	M&A	IPO	M&A
Biopharmaceuticals	2	12	7	19	21	13
Healthcare Serv.	2	9	1	4	0	4
Medical Devices	3	15	0	9	4	11
Medical IS	1	10	0	8	0	8
Comm. and Network	1	47	0	51	0	27
Elect. & Computer Hdw	0	11	3	9	0	9
Information Serv.	3	62	3	31	0	13
Semiconductors	0	15	3	23	3	15
Software	1	142	1	140	3	75
Other	7	80	4	38	3	15
Total	20	403	22	332	34	187

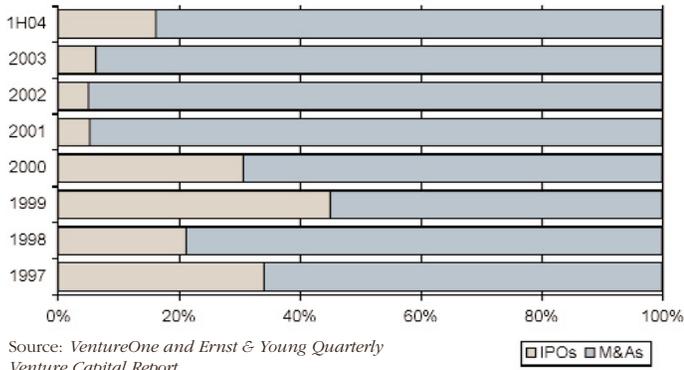
Source: VentureOne and Ernst & Young Quarterly Venture Capital Report

US VC-Backed M&A Activity, 2002-2Q04



Source: VentureOne and Ernst & Young Quarterly Venture Capital Report

US IPOs vs. M&As

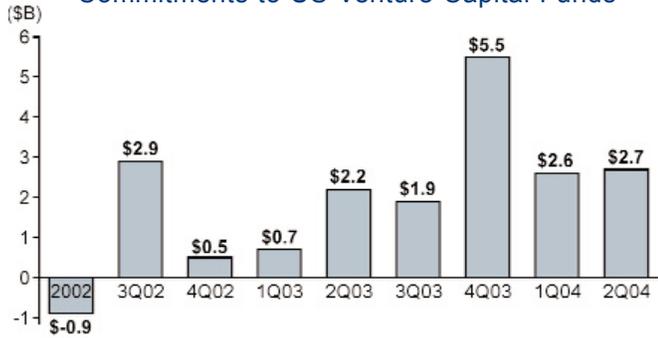


Source: VentureOne and Ernst & Young Quarterly Venture Capital Report

companies have experienced; optimism because there are a number of new labor and end markets for their portfolio companies to utilize; and frustration because of intense competition among portfolio companies and venture firms.

The bottom line is that there are only a handful of good investment outcomes each year. There are those VCs who believe that domestic markets are currently saturated, both in terms of fundraising and investments. VCs are masters of adaptation and, along with their LPs, they are committed to refining their strategies and have turned to scouring the earth to find those investment opportunities. While this alignment may be new, it may be more defensive than opportunistic: GPs and LPs are looking for trusted partners and proven performers, especially as they enter the “wild, wild west” of unproven investment markets. Because, as one industry watcher put it, “Some will succeed and some will lose their shorts.”

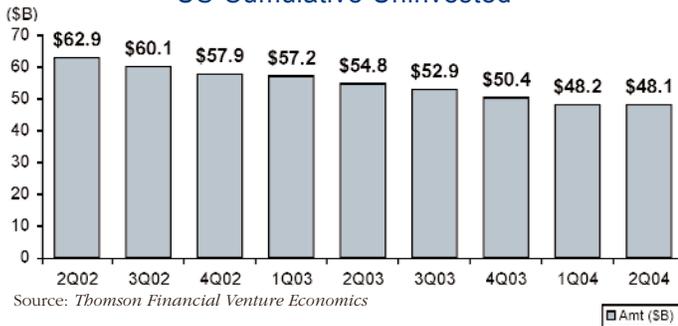
Commitments to US Venture Capital Funds



Source: Thomson Financial Venture Economics

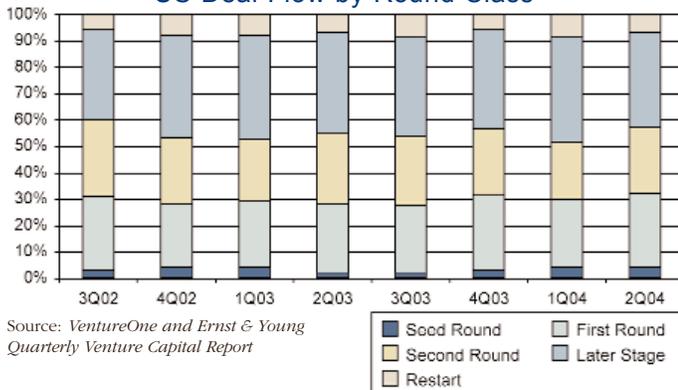
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US Cumulative Uninvested



Source: Thomson Financial Venture Economics

US Deal Flow by Round Class



Source: VentureOne and Ernst & Young Quarterly Venture Capital Report

Cumulative Fund Type Performance as of 03/31/04

Calculation Type: IRR

Fund Type	Num	Avg	Cap Wtd Avg	Max	Upper Quartile	Min
Early/Seed VC	532	14.6	3.9	721.1	17.0	-76.9
Seed Stage VC	64	8.5	0.6	259.2	14.6	-58.4
Early Stage VC	468	15.5	4.1	721.1	17.5	-76.9
Balanced VC	415	9.0	4.0	195.2	15.2	-65.1
Later Stage VC	184	9.8	3.9	209.2	16.3	-65.9
All Venture	1131	11.8	3.9	721.1	16.2	-76.9
Small Buyouts	176	12.0	9.0	273.9	18.1	-52.9
Med Buyouts	107	11.8	11.5	306.1	18.4	-52.1
Large Buyouts	80	7.0	6.9	91.3	14.3	-57.1
Mega Buyouts	101	4.1	3.6	77.2	14.4	-54.1
All Buyouts	464	9.4	5.4	306.1	16.6	-57.1
Mezzanine	63	6.8	6.0	55.4	13.2	-48.6
Buyouts & Other PE	596	9.0	5.2	306.1	15.8	-57.1
All Priv Equity	1731	10.8	4.8	721.1	16.2	-76.9

Source: Thomson Financial Venture Economics/NVCA

Cumulative Vintage Year Performance as of 03/31/04

Venture Capital Funds (only)

Calculation Type: IRR

Vintage Year	Num	Avg	Cap Wtd Avg	Max	Upper Quartile	Min
1992	27	22.3	25.8	102.3	31.6	-47.2
1993	40	21.7	29.2	98.6	34.3	-25.0
1994	41	25.2	33.0	113.0	39.8	-47.9
1995	45	44.2	51.0	247.8	62.0	-29.6
1996	34	74.1	62.6	454.9	96.6	-23.4
1997	59	47.2	45.3	296.1	59.7	-69.8
1998	74	31.8	30.3	721.1	16.1	-45.3
1999	105	-13.6	-14.6	141.4	-2.0	-65.9
2000	106	-13.7	-11.5	51.2	-3.9	-58.4
2001	54	-10.9	-13.5	42.9	-2.4	-47.2
2002	15	-11.9	-13.4	61.9	-1.2	-58.7
2003	7	-35.2	-24.0	38.1	-18.8	-76.9

Source: Thomson Financial Venture Economics/NVCA

Equity Financing* for U.S. Venture-Backed Companies, by Industry Group (2002-1H04)

*Equity financings include cash investments by professional venture capital firms, corporations, other private equity firms, and individuals into companies that have received at least one round of venture funding

Industry Segment	2002 Totals				2003 Total				1H04 Total			
	# of Deals	Median (\$M)	Amt Invested (\$M)	% of Total	# of Deals	Median (\$M)	Amt Invested (\$M)	% of Total	# of Deals	Median (\$M)	Amt Invested (\$M)	% of Total
Biopharm.	232	8.7	3,146	15%	207	12.0	3,481	19%	98	12.5	2,274	22%
Healthcare Serv.	45	7.1	396	2%	30	6.0	276	2%	13	7.6	156	1%
Med Devices	165	8.4	1,639	8%	178	7.5	1,719	9%	85	6.5	748	7%
Medical IS	87	4.5	479	2%	65	3.7	307	2%	33	5.0	189	2%
Healthcare Total	529	7.1	5,660	26%	480	7.2	5,782	32%	229	8.0	3,367	32%
Comm. And Network	290	10.1	4,716	22%	243	10.0	2,931	16%	107	10.0	1,329	13%
Elect. & Computer Hdw	101	7.0	1,131	5%	82	10.0	880	5%	58	10.1	691	7%
Information Serv.	98	3.3	553	3%	88	4.6	590	3%	43	5.0	361	3%
Semiconductors	129	8.0	1,477	7%	136	10.0	1,668	9%	87	10.0	915	9%
Software	715	5.9	5,207	24%	634	5.3	3,998	22%	306	7.0	2,494	24%
Other IT				0%				0%				0%
Info. Tech. Total	1333	6.8	13,083	60%	1183	6.7	10,067	55%	601	8.0	5,791	56%
Consum. & Bus. Prod.	29	2.0	140	1%	31	3.8	249	1%	17	5.1	100	1%
Consum. & Bus. Serv.	339	5.0	2,214	10%	251	5.0	1,779	10%	108	5.0	892	9%
Retailers	24	5.5	170	1%	15	5.2	121	1%	12	4.8	115	1%
Products & Serv. Total	392	4.7	2,524	12%	297	5.0	2,149	12%	137	5.0	1,107	11%
Other Total	53	4.0	372	2%	64	3.6	353	2%	34	4.7	163	2%
Grand Total	2307	6.3	21,639	100%	2024	6.1	18,351	100%	1001	7.0	10,428	100%

Source: VentureOne/Ernst & Young

This update is for informational purposes only and is not a solicitation or recommendation that any particular investor should invest in any particular industry, security, or fund.