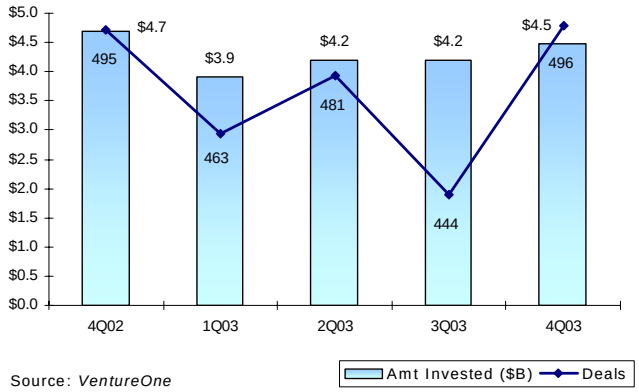
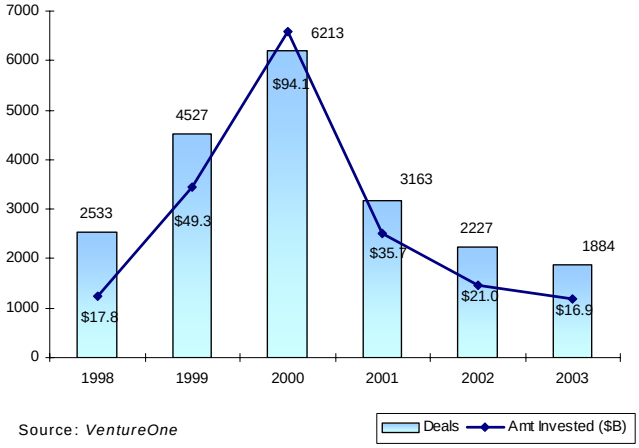
At Silicon Valley Bank, understanding the industries we serve is fundamental. Like you, we track, study and analyze the activity in our markets and, as your partner, we want to share our findings. This report chronicles venture capital activity in Q4 2003 and includes commentary from our vantage point 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 our ongoing dialogue regarding the opportunities ahead of us.

Equity Investing Activity
(by quarter)



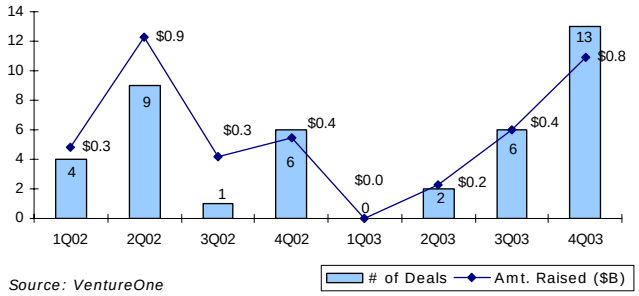
Source: *VentureOne*

Equity Investing Activity
1998-2003



Source: *VentureOne*

Venture-backed IPOs
Deals & Dollars



Source: VentureOne

INDUSTRY COMMENTARY

By Aaron Gershenberg

> "A cynic is a man who, when he smells flowers, looks around for a coffin. "
> -- H. L. Mencken

There have been many cynics in the venture capital industry over the past few years. Some have argued that the industry is dead, innovation over, and compelling returns a thing of the past. If there is one thing that everyone agrees upon, it is that we have been through the worst winter in the history of venture capital. Fortunately there are signs that Spring is on the way. General Partners (GPs) and Limited Partners (LPs) are taking great solace in positive trends in liquidity, valuations and investing.

Liquidity Events: Life-Blood Of The Venture Capital Industry

A healthy IPO market is critical to the health of the venture industry. At its heart, venture capital is a business that requires hitting home runs, with IPOs offering the best opportunity to hit the ball out of the park. Liquidity events through IPOs grew this past year from nearly zero to the highest level per quarter since 2000. In the first quarter of 2003 there were no IPOs, a first in the history of the Nasdaq. By the end of the year there were 21 IPOs, with 13 in the fourth quarter, making 2003's IPO activity similar to 2002.

Strong company performance in the initial quarters after an IPO is critical to keeping the IPO window open and making room for others. Companies are not forgiven for missing their numbers and if too many do, it negatively impacts the ability of other companies to access the public markets. Fortunately, the increased IPO activity in the fourth quarter, the backlog of registrations and Google's potential IPO on the horizon, have combined to put new bounce in the step of investment bankers and GPs.

Mergers and acquisitions (M&As) have always provided the dominant share of liquidity to the venture capital industry. Last year there were 297 companies sold, with 73 of those transactions taking place in the fourth quarter. While the number of transactions was down by more than 25% from 2002, the valuations of these sales were significantly up, nearly 30% higher than 2002. Even with 72 fewer companies sold, the venture industry generated $1.4 billion more in liquidity. It is interesting to note that the Nasdaq rose 31% (correlating closely to increased M&A valuations) from January through December of last year, with a rise of 8.5% in the fourth quarter alone. This rise in the public markets has provided the M&A currency necessary for public companies to aggressively pursue new technologies and new markets, while generating much needed liquidity for the venture capital industry.

Valuation Cynics Abound

Every GP in the industry readily offers unsolicited stories about deals that have gotten stratospherically priced through competition or a deal lost to "dumb" money which stepped-up for absurd valuations. With a large smile and often a laugh, the same GP may immediately relate a story of a portfolio company that got an unsolicited term sheet at significant step-up to the previous round. Industry data from 2003 tells another story. According to VentureOne, the median size

Region Report

Report Dates: 10/01/2003- 12/31/2003

Region	# of Deals	# of Invest. Firms	Average Per Deal	Sum Inv ($M)	% of Invest.
Silicon Valley	149	288	$11.61	$1,631.77	36.4%
Midwest	21	16	$4.52	$99.55	2.2%
New England	69	149	$10.53	$677.86	15.1%
NY Metro	26	58	$8.86	$217.70	4.9%
Texas	25	58	$12.87	$313.40	7.0%
DC/ Metroplex	23	48	$8.07	$171.04	3.8%
Southeast	37	91	$7.39	$278.87	6.2%
LA/ OrangeCo.	22	58	$9.80	$205.98	4.6%
Northwest	27	57	$6.58	$175.21	3.9%
San Diego	19	53	$9.51	$161.45	3.6%
North Central	8	22	$5.47	$43.60	1.0%
Philadelphia	10	30	$9.40	$85.45	1.9%
Colorado	11	25	$6.72	$73.53	1.6%
Sacramento/ N. Cal	3	9	$6.27	$18.80	0.4%
Upstate NY	5	12	$4.54	$20.63	0.5%
South Central	2	4	$20.00	$40.00	0.9%
South West	5	13	$4.17	$34.00	0.8%
AK/HI/PR	5	7	$1.89	$19.55	0.4%
Other	29	NA	NA	$218.00	4.9%
Total	**496**	**703**	**$9.58**	**$4,486.39**	**100.0%**

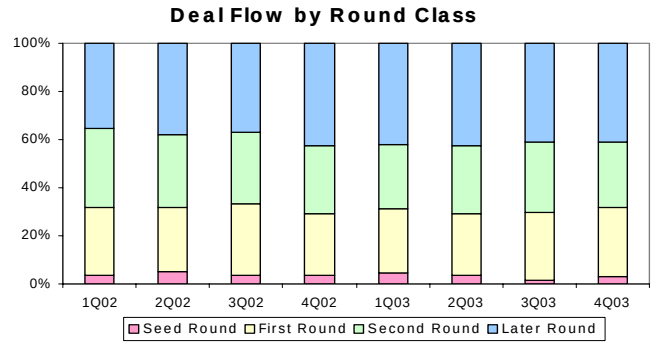
Source: VentureOne

Post Money Valuation Report

Report Dates: 10/01/2003- 12/31/2003

Industry Segment	Sample	Median
Biopharmaceuticals	19	21
Healthcare Services	1	NS
Medical Devices	20	11.6
Medical Information Systems	5	10.7
Communications & Networking	17	18.5
Electronics & Computer Hardware	6	16
Information Services	4	11.75
Semiconductors	9	10
Software	38	11.8
Consumer & Business Products	3	NS
Consumer & Business Services	17	9.9
Retailers	1	NS
Other	4	3.45
Total	**144**	**10.65**

Source: VentureOne



Source: *VentureOne*

of rounds was down 7% in the fourth quarter to $6.5 million and valuations had dropped to levels not seen since 1995, with an average of $10 million per round.

As much as GPs are complaining, current conditions represent a dramatic improvement in the industry. In 2002 and well into 2003, Seed and Series A investors were not getting paid for the risks they were taking. The general rule of thumb was that one would give up half of the company for the amount of money being raised, regardless of the round. Today, with many companies experiencing tangible revenue traction, valuations are increasingly based on forward revenue multiples. Not only are up valuations between rounds a welcome change, draconian terms such as multiple liquidation preferences have seemingly passed away.

GPs and LPs Coming Out of Hibernation

From 2002 to 2003, the amount invested in emerging companies, and the number of companies in which GPs invested, dropped 20% and 15% respectively. That said, GPs invested $4.5 billion in 496 companies in the fourth quarter of 2003, up 12% over the previous quarter. What started out as a very slow year picked up momentum as the public markets and resulting liquidity improved.

While GPs were looking for investment opportunities, there was a dramatic change among LPs evaluating fund opportunities as they began to realize liquidity from previous commitments. A source of contention among LPs the past three years has been the capital overhang from the billion-plus funds and the numerous funds raised in 1999 and 2000. As a result, potential LPs met GPs who hit the road to raise new funds in early 2003 with widespread skepticism. As the year progressed, the fundraising environment improved. According to the NVCA, GPs of 43 funds closed on $5.2 billion in the fourth quarter, up over 166% from the third quarter. 133 venture firms raised $10.8 billion in 2003, a level of activity last achieved in 1995, excluding 2000 and 2001. That improved trend is expected to continue into 2004 – a good thing, as more than half of the funds in the venture capital industry are expected to be out fundraising this year. Funds are expected to continue to be one-half to one-third the size of previous funds as capital investments of $50-100M per partner are targeted, depending on the fund's stage and sector focus.

Though GPs and LPs are mindful that too much capital will depress returns, the industry faces a significant challenge with too much capital seeking allocations in too few funds. A further complication has been posed by the disclosure of information by LPs subject to the Freedom of Information Act (FOIA). Many GPs do not want LPs who are subject to FOIA because they are concerned that confidential information on companies and fund performance will end up in the public domain – something that happened numerous times this past year. As a result, long-time LPs such as the University of Michigan and the University of California have been kicked out of funds like Sequoia Capital and not invited into other funds with the best track records. International LPs, not subject to FOIA, are knocking on every door looking for an opportunity to pick-up any of the table scraps created by FOIA LPs being left out in the cold.

The problem of too many LPs and too much money is resulting in fewer and smaller allocations, and has given rise to a hot new category of fund -- Emerging Manager Funds (EMFs). EMFs are funds whose GPs, while experienced in investing, have not yet realized the kind of meaningful liquidity that would set them apart as proven fund managers. Some argue that most of the funds in the industry fall into this category, given the aging population of "household name" GPs, many of whom are starting to retire. Evaluating the future potential success of EMFs has significant challenges. In many cases the partnership dynamics and stability of

4Q 2003 Most Active Investors

Firm Name	Under Mgmt ($M)	# of Deals in 4Q03
New Enterprise Associates	$5,000	20
Polaris Venture Partners	$2,003	19
Sevin Rosen Funds	$2,000	16
Accel Partners	$3,000	9
Mobius Venture Capital	$2,211	13
Menlo Ventures	$2,710	12
U.S. Venture Partners	$3,200	12
Versant Ventures	$683	12
St. Paul Venture Capital	$3,000	11
JPMorgan Partners	$24,000	11
Intel Corporation*	$750	10

** Corporate VC*

Source: VentureOne

VC-Backed Liquidity by Industry 2001-2003

	2001		2002		2003	
Industry Segment	IPOs	M&As	IPOs	M&As	IPOs	M&As
Biopharmaceuticals	3	15	1	11	7	17
Healthcare Serv.	3	5	2	6	1	3
Medical Devices	4	16	3	15	0	7
Medical IS	1	13	1	8	0	6
Communications & Networking	2	31	0	41	3	51
Electronics & Computer Hardware	0	16	1	8	1	7
Information Serv.	1	55	1	39	0	30
Semiconductors	2	16	0	11	3	21
Software	4	99	3	117	4	137
Other	2	126	8	101	3	36
Grand Total*	**22**	**392**	**20**	**357**	**22**	**315**

Source: *VentureOne*

a fund are as important as the ability of the fund manager to source and manage new investments. In other cases, GPs have "bubble returns" (momentum returns from the late 1990s where anything could get liquid) or significant unrealized returns. Even with succession issues, brand name funds are oversubscribed given the improving liquidity environment and pressure from LPs to get allocations. The funds being left in the cold are first time fund managers and those who have invested one or two funds with disappointing results.

Change or Die

Don Valentine of Sequoia contends that the venture industry must evolve or perish. Delivering the keynote talk at the November SVB Strategic Investors Fund and Silicon Valley BancVentures LP meeting, Don looked back though the history of company formation to make the point that GPs need to take more risks, make more "off the beaten path" investments, and stop imitating each other. At the forefront of GPs' minds is determining how China and India will influence the future of the venture capital industry. Whether accessing the huge growing markets or outsourcing development and services, the implications of China and India as centers for innovation and company formation will have dramatic implications for the venture industry. In order to be relevant, GPs proactively participate in the opportunities being created.

The opportunity for the venture industry to provide compelling financial returns has never been clearer. Domestic and international markets are large and growing. Start-up companies are beginning to enjoy significant revenue traction after several years of Sisyphean efforts. For the first time in many quarters, GPs are generating liquidity for their LPs. Companies that were financed in 2001 and 2002 at historically low valuations, are just beginning gain momentum. Although the cynics remain, the blossoming of these investments represents the coming of Spring, rather than a funeral. There is more good news on the way.

Aaron Gershenberg, Venture Capital Niche Coordinator
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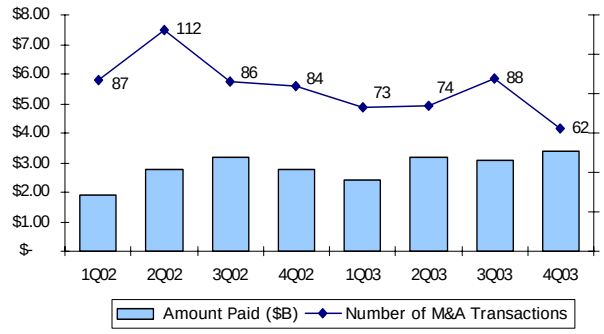
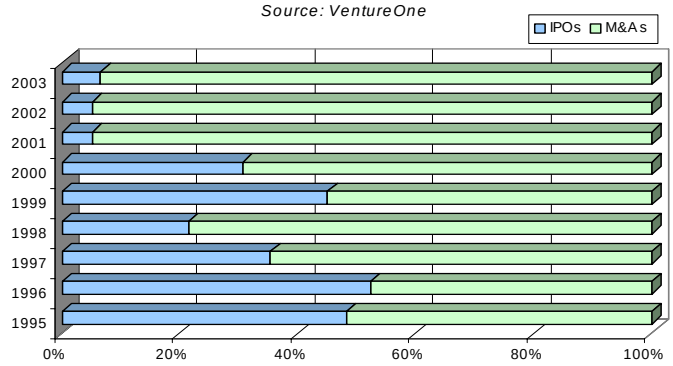
VC-Backed M&A Activity, 2002-2003

Source: *VentureOne*

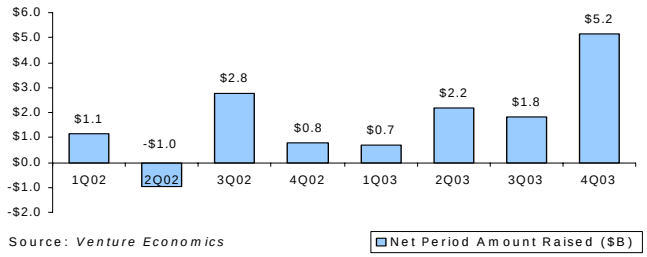


IPOs vs. M&As -- 4Q 2003

Source: VentureOne

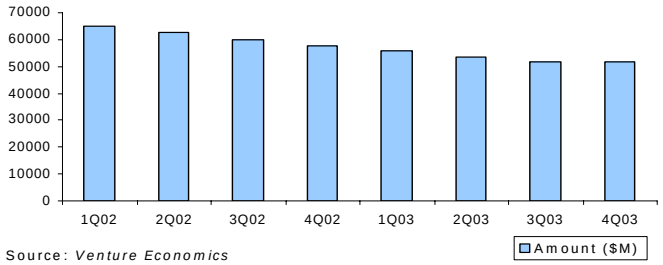


Commitments to US Venture Capital Funds



Source: *Venture Economics*

Cumulative Uninvested



Source: *Venture Economics*

Equity Financings* for US Venture-Backed Companies, by Industry Group (2001-2003)

**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*

	2001 Total				2002 Total				2003 Total			
Industry Segment	Deals	Amt Invested ($M)	Median $	% of Total	Deals	Amt Invested ($M)	Median $	% of Total	Deals	Amt Invested ($M)	Median $	% of Total
Biopharm.	270	3,568.8	8.4	9%	229	3,159.0	9.0	10%	194	3,360.8	12.5	10%
Healthcare Serv.	35	347.3	6.0	1%	44	403.2	7.7	2%	30	164.7	4.8	2%
MedDevices	194	1,855.1	6.1	6%	163	1,625.0	8.6	7%	168	1,614.7	7.9	9%
Medical IS	101	744.4	5.0	3%	83	450.3	4.4	4%	56	254.1	4.0	3%
Healthcare Total	**600**	**6,515.6**	**6.9**	19%	**519**	**5,637.6**	**7.2**	23%	**448**	**5,394.3**	**7.5**	24%
Comm. &	413	8,950.5	14.0	13%	287	4,480.4	10.0	13%	236	2,818.0	10.0	13%
Electronics &	118	1,498.0	8.0	4%	93	1,095.5	7.7	4%	78	803.0	9.2	4%
Information Serv.	203	1,940.7	5.4	6%	90	536.2	4.0	4%	80	559.7	4.7	4%
Semiconductors	169	2,491.4	11.2	5%	117	1,381.3	8.8	5%	122	1,403.3	10.0	6%
Software	954	8,136.4	6.0	30%	694	5,117.6	6.0	31%	586	3,693.6	5.0	31%
Other IT				0%				0%				0%
Info.Tech. Total	**1857**	**23,017.0**	**8.0**	59%	**1281**	**12,611.0**	**7.0**	58%	**1102**	**9,277.6**	**6.6**	58%
Consumer & Business Products	37	337.8	2.5	1%	27	125.0	1.3	1%	28	264.8	5.0	1%
Consumer & Business Serv.	576	5,175.7	6.0	18%	329	2,184.1	5.0	15%	229	1,588.0	5.0	12%
Retailers	43	308.5	5.0	1%	23	156.1	5.0	1%	14	108.5	4.5	1%
Products &	**656**	**5,822.1**	**5.4**	21%	**379**	**2,465.3**	**4.7**	17%	**271**	**1,961.2**	**5.0**	14%
Other Total	**50**	**314.8**	**3.4**	2%	**48**	**324.9**	**3.9**	2%	**63**	**261.4**	**3.0**	3%
Grand Total	**3163**	**35,669.5**	**7.0**	100%	**2227**	**21,038.7**	**6.4**	100%	**1884**	**16,894.5**	**6.3**	100%

Source: VentureOne/Ernst & Young

Cumulative Fund Type Performance as of 9/30/2003

Calculation Type: IRR

Fund Type	Num	Avg	Cap Wtd Avg	Max	Upper	Min
Early/Seed VC	523	14.1	1.8	721.1	17.7	-94.9
Seed Stage VC	63	8.1	-0.4	258.9	13.9	-64.2
Early Stage VC	460	14.9	1.9	721.1	18	-94.9
Balanced VC	413	8.5	1	193.5	15.1	-58.3
Later Stage VC	182	8.6	0.5	209.3	16.3	-95.9
All Venture	1118	11.1	1.2	721.1	16.4	-95.9
Small Buyouts	174	11.3	7.5	243.9	18.5	-75.4
Med Buyouts	106	13.4	13.3	521	20.3	-63.1
Large Buyouts	79	1.2	1.1	91.3	14.7	-99
Mega Buyouts	100	-0.4	-2.7	60.2	10.7	-91.7
All Buyouts	459	7.5	0.4	521	17	-99
Mezzanine	63	6	5.1	56.5	12.1	-59.5
Buyouts and Other PE	585	7.6	1.1	521	15.5	-99
All Priv Equity	1707	9.9	1.1	721.1	16.2	-99

Source: *Thomson Financial Venture Economics / NVCA*

Cumulative Vintage Year Performance as of 9/30/2003

Venture Capital Funds (only) — Calculation Type : IRR

Vintage Year	Num	Avg	Cap Wtd Avg	Max	Upper	Min
1992	27	22.3	25.8	102.3	31.7	-47.2
1993	40	21.8	29	98.6	34.5	-25
1994	40	24.9	33.1	113	41.9	-48.7
1995	45	44.3	51.1	247.8	62.3	-30.3
1996	35	72.5	62.2	463.8	96	-19
1997	59	45.4	41.1	296.2	60.1	-39
1998	72	33	30.3	721.1	17.6	-48.2
1999	104	-15.9	-17.7	142.2	-3.8	-95.9
2000	104	-18.8	-17.7	25.4	-6.5	-64.2
2001	52	-14.6	-17.8	35.1	-3.8	-63.7
2002	13	-16.2	-20	39.8	-12.8	-49.5
2003 (less than 3 funds)						

Source: *Thomson Financial Venture Economics / NVCA*

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