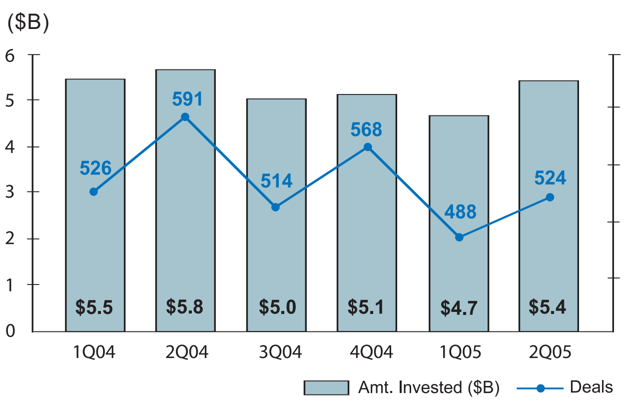
Quarterly Venture Capital Update

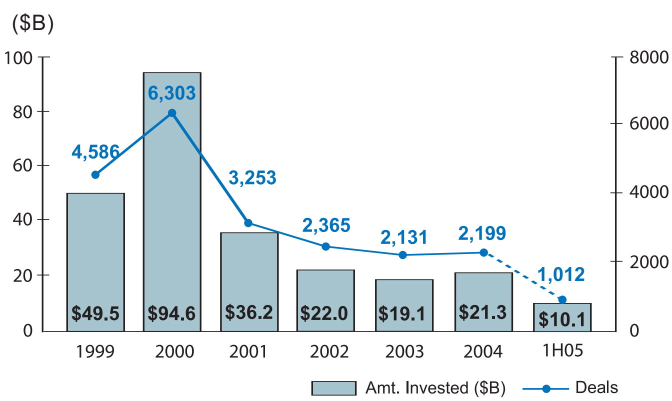
At SVB Financial Group, understanding the industries we serve is fundamental. Like you, we track, study and analyze the activity in our markets and, as your partner, we want to share our findings. This report chronicles venture capital activity in Q2 2005 and includes commentary from our vantage point 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.

U.S. Venture Capital Investing Activity



Source: *VentureOne and Ernst & Young Quarterly Venture Capital Report*

U.S. Venture Capital Investing Activity



Source: *VentureOne and Ernst & Young Quarterly Venture Capital Report*

One Destination, Two Roads: Illuminating the GP/ LP Relationship

By John Otterson and Katie Knepley, SVB Capital

In each of the past four years, venture capitalists have invested roughly $20 billion into their portfolio companies. Fundraising by venture funds over this same period did not keep pace, causing a decrease in the overhang, or pool of un-invested capital held by venture firms. Over the past four quarters, however, a step up in fundraising by venture firms has averaged $5.7 billion, resulting in a stabilization of the overhang to an amount that equates to roughly six quarters of investment capital. With this resurgence of fundraising, venture firm general partners (GPs) and institutional limited partners (LPs) re-engaged in the fundraising process. In doing so, they were reminded once again that while they share the same first-order priority — to create wealth — differences in second-order priorities and strategies cause a natural tension between GPs and LPs. In our experience observing both GPs and LPs, we have found those who understand these differences are best positioned to create successful long-term partnerships.

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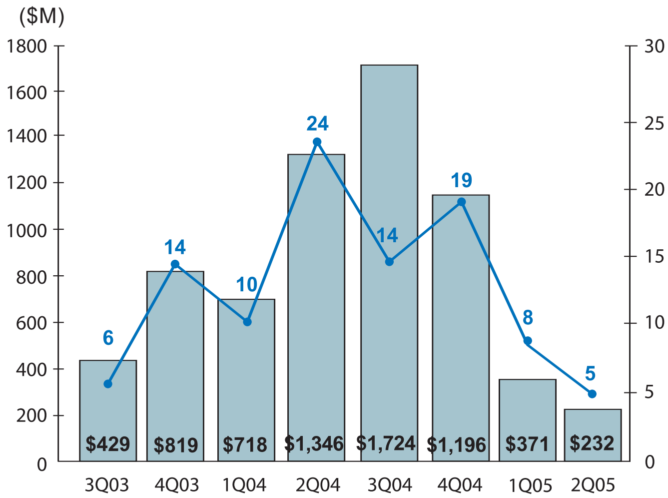
U.S. Venture-Backed IPOs
Deals & Dollars



Source: *VentureOne and Ernst & Young Quarterly Venture Capital Report*

Region Focus All Industries - 2Q05

	# of Deals	# of Investing firms	Average Per Deal ($M)	Sum Inv. ($M)	% of Investment
Bay Area	154	283	$12.6	$1,801.8	33.4%
Midwest	10	103	$8.9	$88.7	1.6%
New England	68	136	$8.0	$542.7	10.1%
New York Metro	31	74	$29.0	$834.0	15.5%
Texas	25	62	$9.2	$217.4	4.0%
Potomac	27	60	$6.2	$161.5	3.0%
Southeast	26	69	$11.0	$258.3	4.8%
Orange County	15	42	$12.3	$180.4	3.3%
Los Angeles	15	39	$9.9	$145.6	2.7%
San Diego	23	68	$11.7	$252.3	4.7%
Oregon	5	16	$8.7	$43.5	0.8%
Philadelphia	12	43	$11.1	$123.5	2.3%
Colorado	14	44	$9.3	$127.9	2.4%
Washington State	26	70	$8.9	$231.6	4.3%
Southwest	11	29	$10.6	$110.6	2.1%
Research Triangle	7	31	$11.0	$76.7	1.4%
Total	524	787	$10.9	$5,387.8	

Source: *VentureOne and Ernst & Young*

Post Money Valuation Report ($M) - 2Q05

Biopharmaceuticals	$30.2
Healthcare Services	$35.6
Medical Devices	$40.0
Medical Information Systems	$9.5
Communications & Networking	$29.3
Electronics & Computer Hardware	$34.5
Information Services	NS
Semiconductors	$16.1
Software	$23.0
Consumer & Business Products	NS
Consumer & Business Services	$18.5
Retailers	NS

Source: *VentureOne*

History of the GP/LP Relationship

When LPs and GPs act as a single team, their roles are unambiguous and it is clear that the success of the fund itself is the priority; however, when each is viewed as a separate entity, their roles and priorities diverge.

An LP is tasked with constructing a portfolio of venture firms that is well diversified in risk and return potential. While the LP's primary goal is to realize superior returns from the managers in which they invest, their challenge is to make selection decisions today that will bring rewards six to ten years later. Therefore, when constructing a venture capital portfolio, LPs generally apply a developed and standard due diligence methodology to their selection process, based upon a set of second-order priorities.

GPs aim to optimize their careers and the success of their firms. To achieve these objectives, the GP must apply sound judgment and business acumen in order to create positive returns over the long term. At the same time, GPs are faced with an increasingly competitive, dynamic, and efficient landscape that complicates their job. As this landscape evolves, GPs are constantly looking to capitalize on new opportunities and adapt to new market conditions. In executing this approach, GPs believe that they have the best perspective and judgment to evolve their strategy or team to be ideally positioned to create wealth and positive returns.

Although the common goal for GPs and LPs is to create wealth over time, the difference in their second-order priorities and methodologies creates numerous points of divergence, causing a natural tension between the groups. In many instances GPs and LPs agree on the relevant indicators of future success, but disagree on the interpretation of the details.

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Most Active Investors

Firm Name	Under Mgmt ($M)	# of Deals in 2Q05
New Enterprise Associates	6,000	23
Draper Fisher Jurvetson	3,000	19
Atlas Ventures	2,100	15
Intel Capital*	750	15
Domain Associates	1,406	13
Morgenthaler	2,000	13
U.S. Venture Partners	3,200	13
Sequoia Capital	2,153	12
Venrock Associates	2,000	12
Versant Ventures	683	12

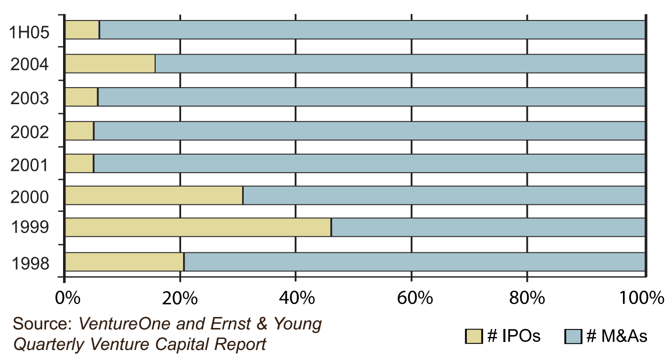
* Corporate VC
Source: *VentureOne and Ernst & Young Quarterly Venture Capital Report*

U.S. VC-Backed Liquidity Events by Industry

	2003		2004		1H05	
	IPO	M&A	IPO	M&A	IPO	M&A
Biopharmaceuticals	7	19	26	33	5	21
Healthcare Services	1	5	0	12	0	6
Medical Devices	0	9	12	21	3	10
Medical IS	0	9	1	14	1	10
Comm. and Networking	3	56	2	49	1	30
Elect. & Computer Hardware	1	10	0	17	0	5
Information Services	0	38	3	44	0	15
Semiconductors	3	23	7	25	0	6
Software	3	143	4	170	0	78
Other	4	41	12	32	3	15
TOTAL	22	353	67	417	13	196

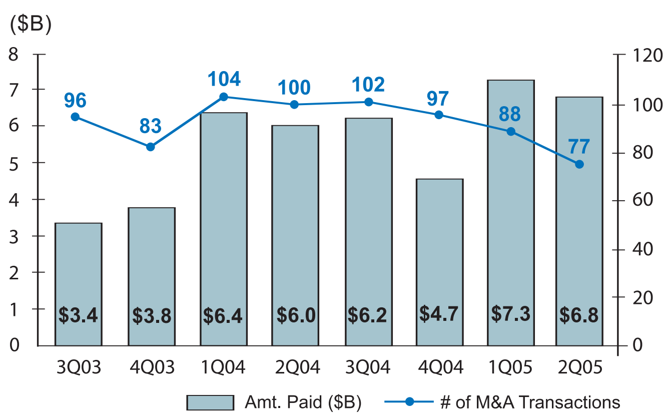
Source: *VentureOne and Ernst & Young Quarterly Venture Capital Report*

U.S. IPOs vs. M&As



Source: *VentureOne and Ernst & Young Quarterly Venture Capital Report*

U.S. VC-Backed M&A Activity



Source: *VentureOne and Ernst & Young Quarterly Venture Capital Report*

Common Vision

Since both GPs and LPs seek to create wealth and they agree on several factors that are essential for a fund to generate positive returns:

- A team that can deliver
- A differentiated strategy
- A logical connection between the GP's expertise and the stated future strategy

As part of their due diligence process, LPs generally seek to focus on each of these factors as a potential indicator of superior future returns. However, as this process advances, so does the probability for divergent points of view, since GPs and LPs may disagree about what constitutes favorable traits for any of these factors.

Where Perspectives Diverge

While LPs and GPs agree that the above factors are important indicators of future success, their disparate responsibilities and roles are highlighted by the different ways that each group evaluates team consistency, strategy, returns and risk. The basis of the difference in second-order priorities comes from the LP preference for stability and predictability, contrasted with the GP's economic incentive to deliver high returns without regard to the LP's overall portfolio constraints.

LPs prioritize team stability because they believe it is an indicator of the team's ability to replicate past successes and therefore reduce future risk. Despite LP distaste for turnover it may be a necessity from the GP perspective. GPs seeking career optimization and the success of their firms may embrace team turnover, as a way to reduce risk through the elimination of an underperformer. GPs will also point out that turnover may be inherent in a highly

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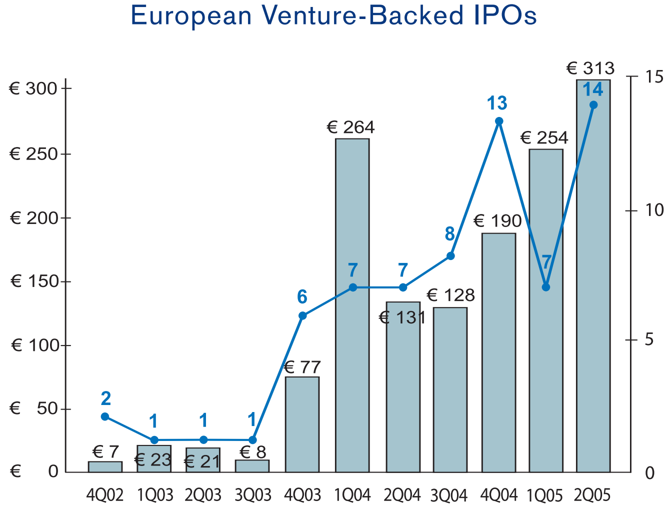

Source: *Dow Jones VentureOne*

SVB Europe Advisors Limited

Perspective

Since the technology bubble burst, European venture capitalists have endured little or no access to the capital markets for IPOs and the only source of liquidity has been through a trade sale. European VCs often looked at the U.S. with envy as the Nasdaq supported high-growth technology companies and provided higher valuations than mainstream European exchanges.

Where once there stood several regional exchanges that were vying to become the pan-European equivalent of Nasdaq, today there remains just one viable market that could take this mantle — AIM.

The London Stock Exchange launched AIM in 1995 as a junior stock market for young companies raising growth capital. During the dotcom boom, AIM took off, but crashed hard when the bubble burst. Within the last year however, AIM has floated more companies than at any other time in its history and more institutions are investing in AIM-traded shares, providing companies with access to more capital, according to a special report on AIM by Growing Business.

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selective succession planning process. Paradoxically, from the GP's perspective, turnover may generate greater stability. As a result, LPs are well advised to delve into the nature and logic of changes in line-up over time in order to ascertain whether those changes are likely to increase or decrease return potential.

LPs are most comfortable with firms that stick to what they know. From the LP perspective, a consistent strategy mitigates risk at the firm level by connecting known skill sets with known opportunity sets. At the portfolio level, this consistency supports the LP's efforts to construct a specific portfolio with exposure to particular strategies. This perspective is so widely held that LPs have developed a name for not adhering to a stated strategy: strategy drift. GPs, however, may be more inclined to update aged strategies in light of changes in the venture landscape. In doing so, they would point out that blind adherence to past strategies in the face of evolving opportunities is foolhardy and certain to induce more risk, not less. Although LPs are resistant to ill-defined strategies, through effective due diligence and a high level of communication from the GP they will be able to evaluate a GP's perspective and judgment in evolving a fund's strategy.

LPs place a high premium on consistency in return origination. Attribution is important to LPs as they are looking to develop a carefully diversified portfolio. They want GPs who can deliver long-term results using as specific an approach and focus as possible. LPs also want to participate in many future funds. Thus strategy drift, even with successful results, can be problematic for LPs, while GPs place a priority on returns, and have less of a concern for strategy attribution. The GP will measure success by making money, regardless of where the returns were originated. LPs appreciate and reward GPs who garner returns tied to stated strategy by continuing to support the firm with commitments. Nevertheless, despite the preference for predictable attribution, it is unlikely that LPs will punish a GP who produces exceptionally high returns on a consistent basis from any source.

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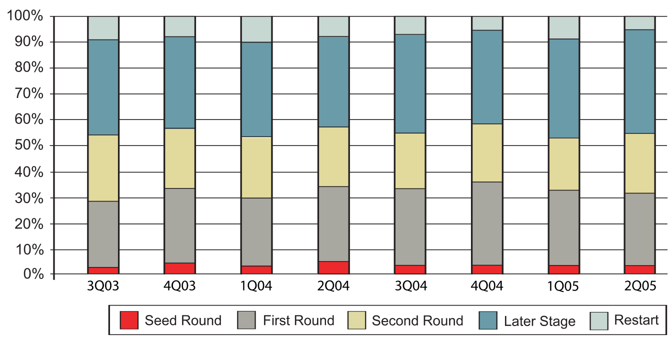
AIM officials told SVB Europe Advisors the in-flow of companies floating on AIM from around the globe is increasing, including companies from the U.S. and Israel. In this situation, VCs and entrepreneurs have enjoyed healthy valuations and a more flexible and favorable regulatory environment when contrasted to the requirements of Sarbanes-Oxley.

That said, the jury is still out on the long term viability of AIM. Stock liquidity and the impact of the inevitable downward effects of a business cycle are still unclear. Until then, many European VCs view AIM as a way to realize some exits and get some liquidity, which in turn should help their fund raising efforts in the short-term. VC

The Bottom Line

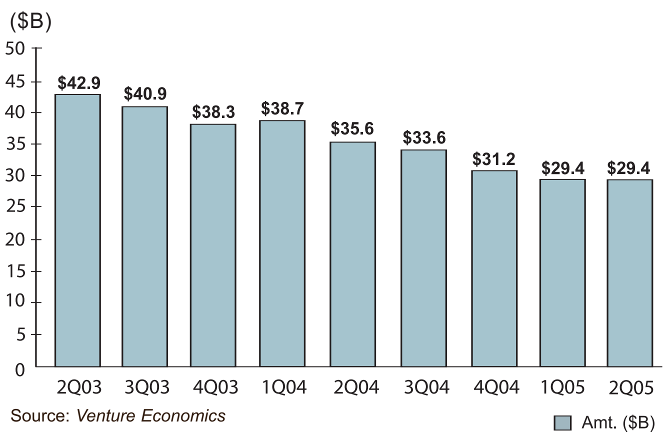
GPs and LPs have the same first-order priority: to create wealth. Due to diverse second-order priorities and roles, there are differences in the methods each party uses to approach and evaluate the potential for future wealth creation. Through thoughtful due diligence and understanding of strategy, GP skills and relevant historical returns, smart and disciplined LPs will construct a portfolio of venture firms that is well diversified in risk and return potential. Despite differences in methods each group uses to attain and measure success, both GPs and LPs will more easily and consistently achieve their goals by understanding the second-order priorities of the other. Although this process may include calculated risk taking and compromise by both parties, the end result will be a long lasting partnership that is mutually beneficial. VC

U.S. Deal Flow by Round Class



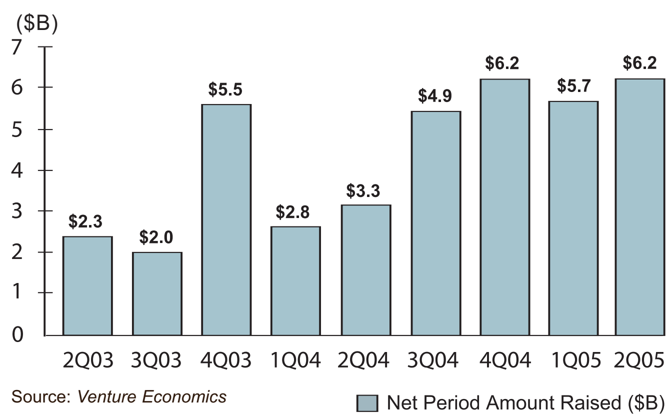
Source: *VentureOne*

U.S. Cumulative Uninvested



Source: *Venture Economics*

Commitments to U.S. Venture Capital Funds



Source: *Venture Economics*

Cumulative Vintage Year Performance as of 3/31/05

Venture Capital Funds (only) Calculation Type: IRR

Vintage Year	Num	Avg	Cap Wtd Avg	Max	Upper Quartile	Min
1993	40	23.4	31.4	116.4	39.8	-25.0
1994	41	24.8	32.7	112.9	39.8	-47.9
1995	47	46.9	60.1	247.8	63.4	-27.9
1996	33	74.9	62.8	454.9	95.8	-23.3
1997	59	47.7	46.0	296.0	60.7	-51.9
1998	79	26.9	25.3	721.0	11.7	-44.8
1999	108	-10.5	-11.7	140.6	-0.8	-100.0
2000	115	-9.3	-7.1	28.5	-1.6	-37.9
2001	53	-6.2	-7.6	27.8	0.0	-29.5
2002	15	-9.9	-8.9	10.3	-3.5	-32.0
2003	9	-12.8	-12.4	39.5	-8.4	-35.9
2004	8	-34.3	-19.4	18.8	-18.2	-86.9

Source: *Thomson Financial Venture Economics/NVCA*

Cumulative Fund Type Performance as of 3/31/05

Calculation Type: IRR

Fund Type	Num	Avg	Cap Wtd Avg	Max	Upper Quartile	Min
Early/Seed VC	542	15.2	6.8	721.0	15.9	-86.9
Seed Stage VC	65	9.0	0.3	258.1	13.3	-35.9
Early Stage VC	477	16.1	7.1	721.0	16.1	-86.9
Balanced VC	432	9.4	5.4	195.2	15.8	-48.4
Later Stage VC	181	9.9	4.8	209.2	14.8	-100.0
All Venture	1155	12.2	5.9	721.0	15.8	-100.0
Small Buyouts	176	12.6	10.2	243.9	18.4	-42.2
Med Buyouts	106	9.7	9.2	81.5	18.6	-61.8
Large Buyouts	85	9.4	8.8	91.3	17	-45.2
Mega Buyouts	106	7.3	7.8	94.0	15.6	-31.6
All Buyouts	473	10.2	8.3	243.9	17.1	-61.8
Mezzanine	64	6.0	5.9	54.1	12.8	-57.9
Buyouts and Other PE	613	9.1	7.8	243.9	15.8	-93.1
All Priv Equity	1772	11.1	7.2	721.0	15.8	-100.0

Source: *Thomson Financial Venture Economics/NVCA*

Equity Financing* for U.S. Venture-Backed Companies, by Industry Group

*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

	2003 Totals				2004 Total				1H05 Total			
Industry Segment	# 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
Biopharmaceuticals	214	11.0	3,627	19%	242	11.5	4,527	21%	102	10.0	1,397	14%
Healthcare Services	31	6.0	294	2%	40	6.7	393	2%	16	10.5	172	2%
Med Devices	185	7.5	1,770	9%	188	6.0	1,651	8%	72	8.3	742	7%
Medical IS	69	4.0	323	2%	51	5.0	329	2%	29	5.0	187	2%
Other Medical	1	0.0	3	0%	0	0.0	0	0%	0	0.0	0	0%
Healthcare Total	500	7.2	6,016	31%	521	7.8	6,900	32%	219	8.3	2,499	25%
Comm. & Networking	258	10.0	3,173	17%	225	9.0	2,781	13%	125	8.7	1,542	15%
Elect. & Computer Hdw	93	8.0	934	5%	117	8.8	1,304	6%	55	8.6	504	5%
Information Services	94	4.3	598	3%	115	5.0	9,061	43%	40	5.3	389	4%
Semiconductors	144	10.0	1,703	9%	164	10.2	1,776	8%	66	9.0	736	7%
Software	681	5.0	4,252	22%	717	6.0	5,283	25%	312	6.1	2,461	24%
Info. Tech. Total	1,270	6.0	10,659	56%	1,339	7.0	12,106	57%	598	7.0	5,632	56%
Consum. & Bus. Prod.	32	4.0	249	1%	26	5.1	167	1%	11	4.5	78	1%
Consum. & Bus. Serv.	251	5.0	1,753	9%	220	5.0	1,596	7%	125	6.0	1,415	14%
Retailers	15	4.0	106	1%	23	3.4	137	1%	10	10.0	89	1%
Products & Serv. Total	298	5.0	2,109	11%	269	5.0	1,900	9%	146	5.5	1,581	16%
Other Total	63	3.5	318	2%	70	4.3	379	2%	49	5.0	396	4%
Grand Total	2,131	6.0	19,102	100%	2,199	7.0	21,285	100%	1,012	7.0	10,109	100%

Source: *VentureOne and Ernst & Young*

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