

SVB ANALYTICS

RESEARCH SERIES

Volume 6

This series of research papers is designed to address what drives value in the unique world of private equity and venture capital. Our studies involve thousands of venture-backed technology and life science companies and data from multiple sources – some of which are survey-based and some from private sources, which we know to be extremely reliable.

“Stayin’ Alive”

The Bee Gees penned this lyric in 1977, a year when the total dollars invested by venture capitalists reached the astronomical level of \$209 million. Today, investors may think wistfully of that era when competition was slight and opportunities were more obvious. As we push deeper into our analysis of the venture-backed world, we find ourselves invariably bringing in the broader investment environment, including the perspective of public markets and strategic investors. As you will see in the following analysis, the current landscape, as well as future expected returns, revolves in a fairly direct manner around that external behavioral dynamic.

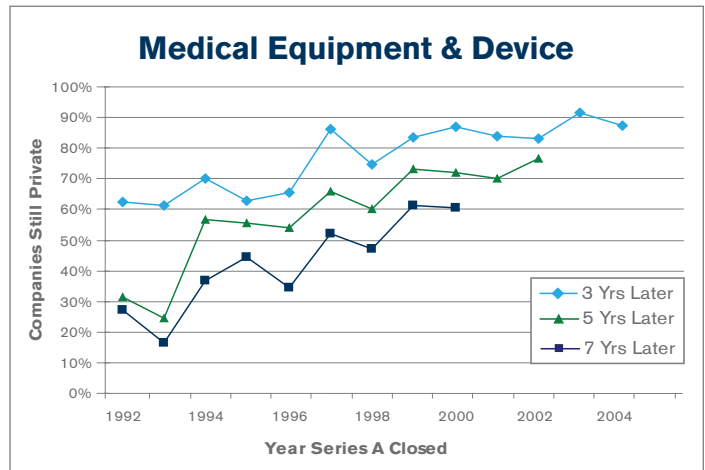
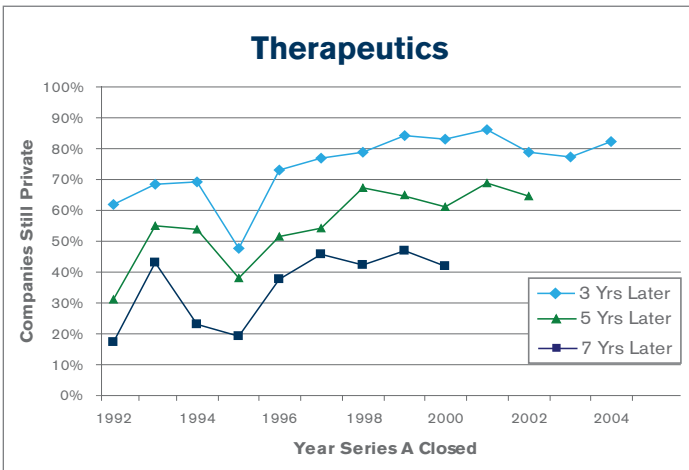
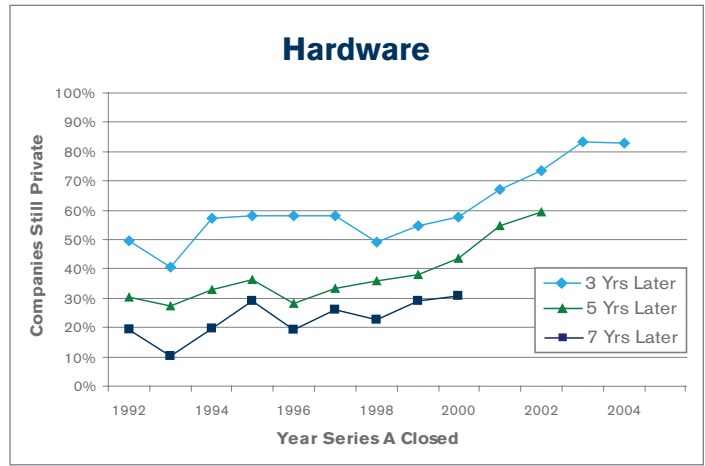
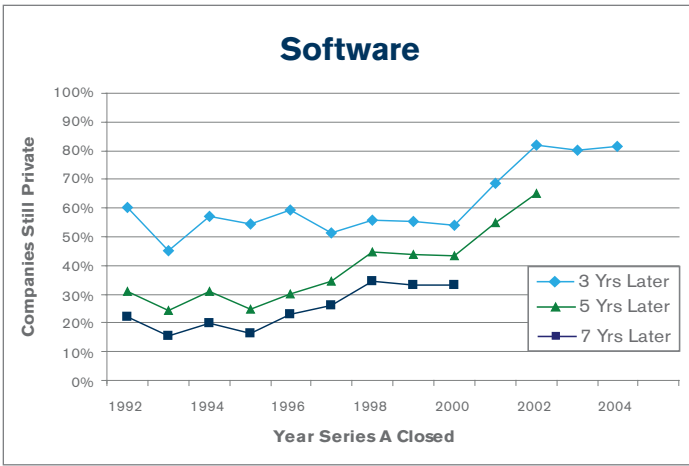
- Jim Anderson, President, SVB Analytics

RUNWAY TO EXIT: THE LONG ROAD AHEAD

Although each industry sector has unique dynamics, our analysis shows that the long term trend line of time-to-exit is steadily increasing. There have been a couple of shocks to the system during the period covered in this analysis, but the overall trend is evident.

This increased time-to-exit likely reflects the maturation of the innovation economy, of which these sectors — software, hardware, therapeutics and medical equipment and device — are all a part. With fully developed R&D organizations, the dominant players no longer rely so heavily on external providers to drive their product development. Consolidation over time has also served to limit the market power to a more select group of companies, minimizing the free-for-all that characterized the early days which led to accelerated exits for venture backed start-ups.

Companies Still Private Grouped by the Year of First Funding




Source: Dow Jones/VentureOne and SVB Analytics

The public market has similarly matured — or at least its view of the investment opportunity represented by an early stage, technology-driven company has matured. The bar is now set higher and exits via IPO are few and far between, further extending the life cycle of these companies. The following report briefly details the history of these time-to-exit dynamics within the software, hardware, therapeutics and medical equipment and device sectors.

SOFTWARE

The software chart reveals that for many years before and through the bubble, the portion of software companies remaining private three years after their first institutional funding was between 50 and 60 percent consistently. For companies closing their Series A in 2002, that number jumped to 80 percent. The IPO nuclear winter certainly contributed to this — and though the window for public



offerings did open a bit in recent years, our data indicates that the aperture was a narrow one compared to earlier opportunities. Additionally, those companies that still have an appetite for software acquisition have had a smorgasbord of bubble companies available at fire sale prices — and our data confirms that these bubble companies comprise the bulk of post-bubble deals.

All of these factors (a weak IPO window, curbed acquisition appetites, and a plethora of M&A targets) have combined to stretch out the time-to-exit. If the “7 Yrs Later” line on the chart continues to closely mirror the “5 Yrs Later” line, we can expect over half of those companies from 2002 to still be private *seven years* later in 2009.

HARDWARE

Semiconductor companies make up a significant portion of our hardware data sample, and years ago we would see clients from this sector go public on hype and a tape-out alone, no chip required. Today a company cannot be taken public on a single chip unless it is a blockbuster and supports multiple products. The Street is no longer giving credit for cool technology; instead it is focusing on business fundamentals.

In addition, exits have been ho-hum, causing investors to become less interested and leaving interested parties to hope for a sale — but even potential acquirers now want products to be accretive. Compounding this, chips today are smaller and more sophisticated resulting in longer development cycles. Our data shows that of the hardware companies that

closed their first institutional funding in 2002, by the end of 2007 60 percent were still private, 19 percent had been acquired, the public exits were negligible, and 21 percent had gone out of business.


THERAPEUTICS

Beginning in 1995, the chart for this sector shows an increase in the number of therapeutics companies staying private longer. Around 2002 there is a slight reversal of this trend as pharmaceutical companies shift the focus of their business development activities to newer companies in an effort to replenish their pipelines cheaply by scooping up promising projects earlier. Unfortunately, the approval rate for the underlying compounds has been disappointing, and most pharmaceutical companies are now opting to wait for better data later in the development cycle — translating to a longer runway to exit for therapeutics companies.

Additionally, the public markets have become much more discriminating, looking for broadly diversified (read: lower risk) and more fully developed pipelines. This higher bar has led to a decline in the number of therapeutics companies completing IPOs.

MEDICAL EQUIPMENT AND DEVICES

The chart for this sector shows significantly higher percentages of companies still private “5 Yrs Later” and “7 Yrs Later” than the other three sectors. The public markets have always been fairly selective for medical device companies, looking for evidence of sales traction and large market opportunities. Since building an independent



sales force is an expensive proposition, most device companies have traditionally sought liquidity through M&A, effectively providing incremental products to the larger companies with established sales forces.

Historically, there have been only a handful of device acquirers as the industry is much more concentrated than the pharmaceutical business. Companies like Boston Scientific, Medtronic, Johnson & Johnson and Guidant were big buyers for a number of years. Boston Scientific's troubled acquisition of Guidant took both companies out of the M&A game and those that were still healthy had a lot of digesting to do from their prior buying binges. So, with limited buyers able to do deals and a limited public market, device companies have been left hanging. Nearly 80 percent of device companies that received their first institutional funding in 2002 were still private five years later (compared to the 60-65 percent from the other industry sectors).

THE ONGOING DEBATE

All of this clearly highlights one of the issues driving the ongoing debate over the fundamental structure of the venture capital business — will exit prices and time frames afford early stage investors an adequate risk/reward dynamic to support the return expectations of general and limited partners? Investors are acknowledging that their participation in new deals may be less aggressive as they focus with intensity on their existing portfolio companies. The core effort may be to ensure that those companies, the pending returns, and ultimately the venture capital business model itself is “stayin’ alive.”

Questions or comments for the author? E-mail [Cindy Moore at cmoore@svb.com](mailto:cmoore@svb.com).



AUTHOR

CINDY MOORE

Cindy Moore joined SVB Analytics as a research director in 2007. She brings more than 10 years of experience in mathematical modeling and statistical analysis. Moore has worked for Andersen Consulting (Accenture) and the Federal Reserve Bank, as well as software start-ups in the affinity recommendation, price optimization and supply chain collaboration sectors. She holds a bachelor's degree in theoretical mathematics from the University of California at Davis and a master's degree in theoretical mathematics from the University of Oregon.

EDITOR

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Jim Anderson is president of SVB Analytics. Anderson joined Silicon Valley Bank in 1999 and has served in a variety of capacities most recently as a founder, president and chief investment officer of SVB Asset Management and founder of SVB Securities. These groups hold total client assets in excess of \$20 billion. He is a contributing columnist to OnPoint, published by SVB Financial Group, and is a frequent speaker on the economy and financial issues affecting the technology and life science sectors.

ABOUT SVB ANALYTICS

SVB Analytics offers valuation and corporate equity administration services to SVB Financial Group's core constituencies of private, venture capital-backed companies and venture capital firms. SVB Analytics' services offerings include fair market IRC409A/FAS123R valuations and corporate equity tracking and administrative services. SVB Analytics is a member of global financial services firm SVB Financial Group, with Silicon Valley Bank, SVB Capital, SVB Global and SVB Private Client Services, which serve the unique needs of technology, life sciences and private equity firms.

More information on the company can be found at www.svb.com.

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