

Venture capital funding, valuations rise  
INVESTORS BECOMING MUCH PICKIER

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Venture capital is on the upswing, the deals are bigger and less risky, and the chances of going public are better. What's not to like?

For VC firms, it seems, not much. Sure, scarred investors from earlier in the decade always worry about a bubble, but there's little sign of that so far, according to most observers.

Yet the implications for valley entrepreneurs are profound. Increasingly, venture capitalists are pouring their money into late-stage companies. That could force some early-stage entrepreneurs to look harder for cash and perhaps bootstrap their companies if the trend continues, despite the \$82 billion VCs have raised since 2004.

"The venture world is in some ways transforming itself," said Mike Cordano, co-founder and chief executive of the San Mateo start-up Fabrik, which received a substantial \$37 million round of funding in April. "In some sense, it's going to change the profile of the entrepreneur."

While trends in venture capital ebb and flow with the economy and the ease with which young companies can sell themselves or launch public offerings, this year's free-spending ways show no sign of changing. After years of shunning IPOs, public-market investors are showing renewed interest in them, and venture capitalists want to cash in.

So far this year, activity in the IPO market has been brisk. During the second quarter, 22 venture-backed companies had coming-out parties, raising \$2.73 billion, the largest amount since the dot-com mania of the third quarter of 2000, according to Dow Jones VentureOne.

And the valuations of these companies prior to their IPOs reflects the larger sums VCs are willing to bet on their futures. The median value leaped to \$320 million, up from \$196 million a year earlier.

Despite that, there seems to be little worry about speculative excess. "I don't see a bubble," said Bruce Robertson, managing director at Atlanta-based venture capitalists HIG Ventures. "There is a lot more discipline in the market than in the 2000 time frame. But I do see some price escalation."

Many observers say the successes of this year's IPOs justify the prices VCs have been willing to pay. Of the 10 Silicon Valley technology companies that sold shares to the public since the start of the year, nine are trading above their initial offering price, some substantially so. For instance, Cavium Networks, a Mountain View chip maker, is up about 99 percent and Sunnyvale software developer Aruba Networks is ahead almost 104 percent.

Venture firms don't want to miss out. In the first quarter, they put \$7.1 billion into 778 deals, an average of \$9 million a company, up from an average of \$7.4 million in 2006, according to figures from PricewaterhouseCoopers, the National Venture Capital Association and Thomson Financial.

This pattern was most pronounced among late-stage companies - those most ready for a public offering - where the average late-stage firm raised \$12.4 million, a 32 percent increase from \$9.4 million in the fourth quarter of 2006.

At the same time, money going into early-stage and seed companies fell 30 percent in the first quarter from the fourth quarter.

"Prices have gone up dramatically since the beginning of the year," noted Keith Benjamin, managing partner at Levensohn Venture Partners. Many say they expect the trend to show up in the second-quarter numbers. "If you get the right deal, you will make money," said Benjamin.

Benjamin says he has seen some inflated values placed on the youngest of Web 2.0 companies. But the majority of the higher prices are for more mature companies, including those in life sciences and clean

energy.

Some VCs say this is the result of too much money chasing too few late-stage deals, and that it gives them pause. "I'm concerned about putting more capital to work," said Kenneth Sawyer, managing director of Saints Capital of San Francisco. "We have hesitations and concerns."

Yet money can still be made investing in these companies, Sawyer said.

"People are trying to give us good deals and put more money in," said Yu Chiang Cheng, chief executive of San Francisco-based World Golf Tour, an early-stage Web 2.0 gaming company that raised money in April from Battery Ventures. "We're all being pushed cash. I think (VCs) really opened the flood gates at the end of last year."

VCs are chasing Internet deals with an enthusiasm not seen since the bubble years, Cheng said. But what's different this time is that venture investors are spending more effort studying their target companies, he said.

Partners from Battery asked for 15 references, five for each top executive, and called everyone on the list, Cheng said. They also spent a lot of time looking at how the online golfing game developer wants to use advertising and sponsorships to make money.

Other entrepreneurs will have an even tougher time. As venture money migrates to late-stage deals, the youngest start-ups may be forced to struggle longer without financial backing while promising late-stage companies swim in a sea of riches.

Many founders may need to rely on their own money or non-VC money for a longer period, said Cordano, whose Fabrik existed for almost 10 months before accepting \$4.1 million of venture financing in November 2005.

"The environment for early-stage companies has become more difficult," agreed Jim Jones, managing director at Scale Venture Partners of Foster City.

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