VENTURE CAPITAL 101:

What is Venture Capital?

Venture capital has enabled the United States to support its entrepreneurial talent and appetite by turning ideas and basic science into products and services that are the envy of the world. Venture capital funds and builds companies from the simplest form – perhaps just the entrepreneur and an idea expressed as a business plan – to freestanding, mature organizations.

Risk Capital for Business

Venture capital firms are professional, institutional managers of risk capital that enables and supports the most innovative and promising companies. This money funds new ideas that could not be financed with traditional bank financing, that threaten established products and services in a corporation, and that typically require five to eight years to be launched.

Venture Capital Backed Companies
Known for Innovative Technology and Products
2000 and 2006 Employment

Company	2000	2006	# Change
Intel Corporation	86,100	103,200	17,100
Microsoft	39,100	71,000	31,900
Medtronic, Inc.	21,490	36,000	14,510
Apple Inc.	8,568	17,100	8,532
Google	—	10,600	10,600

Source: Hoover's

Venture capital is quite unique as an institutional investor asset class. When an investment is made in a company, it is an equity investment in a company whose stock is essentially illiquid and worthless until a company matures five to eight years down the road. Follow-on investment provides additional funding as the company grows. These "rounds," typically occurring every year or two, are also equity investment, with the shares allocated among the investors and management team based on an agreed "valuation." But, unless a company is acquired or goes public, there is little actual value. Venture capital is a long-term investment.

Venture Capital Backed Companies
Known for Innovative Business Models
2000 and 2006 Employment

Company	2000	2006	# Change
The Home Depot	201,000	345,000	144,000
Starbucks Corporation	47,000	116,700	69,700
Staples	49,993	68,500	18,507
Whole Foods Market, Inc.	18,500	38,600	20,100
PetSmart, Inc.	19,825	30,300	10,475
eBay	1,927	12,800	10,873

Source: Hoover's

Venture capital firms are professional, institutional managers of risk capital that enables and supports the most innovative and promising companies.

More Than Money

The U.S. venture industry provides the capital to create some of the most innovative and successful companies. But venture capital is more than money. Venture capital partners become actively engaged with a company, typically taking a board seat. With a startup, daily interaction with the management team is common. This limits the number of startups in which any one fund can invest. Few entrepreneurs approaching venture capital firms for money are aware that they essentially are asking for 1/6 of a person!

Yet that active engagement is critical to the success of the fledgling company. Many one- and two-person companies have received funding but no one- or two-person company has ever gone public! Along the way, talent must be recruited

What Entrepreneurs Are Really Asking For!

An early stage venture capitalist sitting on six company boards has a huge workload.

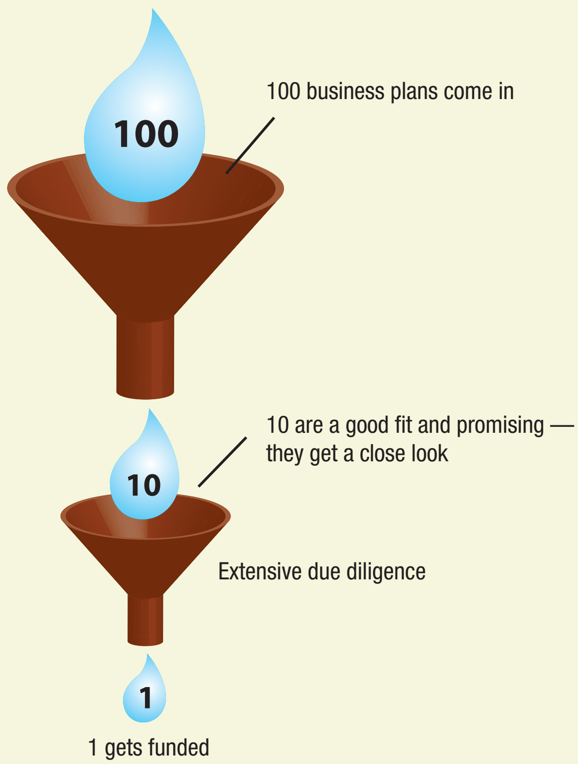
and the company scaled up. Ask any venture capitalist who has had an ultra-successful investment and he or she will tell you that the company that broke through the gravity evolved from the original business plan concept with the careful input of an experienced hand.

Deal Flows — Where The Buys Are

For every 100 business plans that come to a venture capital firm for funding, usually only 10 or so get a serious look, and only one ends up being funded. The venture capital firm looks at the management team, the concept, the marketplace, fit to the fund's objectives, the value-added potential for the firm, and the capital needed to build a successful business. A busy venture capital professional's most precious asset is time. These days, a business concept needs to address world markets, have superb scalability, be made successful in a reasonable timeframe, and be truly innovative. A concept that promises a 10 or 20 percent improvement on something that already exists is not likely to get a close look.

Many technologies currently under development by venture capital firms are truly disruptive technologies that do not lend themselves to being embraced by larger companies whose current products could be cannibalized by this. Also, with the increased emphasis on public company quarterly results, many larger organizations tend to reduce spending on research and development and product development when things get tight. Many talented teams have come to the venture capital process when their projects were turned down by their companies.

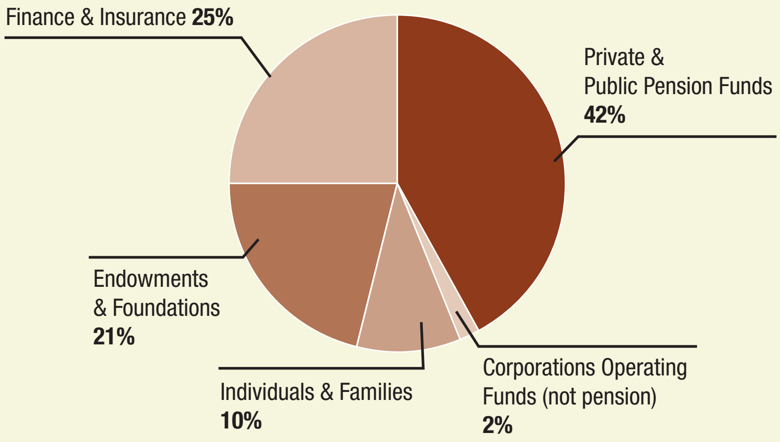
The Business Plan Funnel



Common Structure — Unique Results

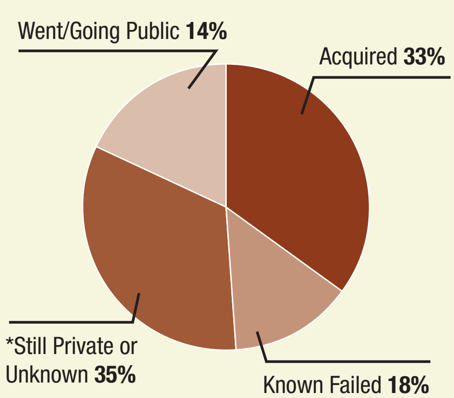
While the legal and economic structures used to create a venture capital fund are similar to those used by other alternative investment asset classes, venture capital itself is unique. Typically, a venture capital firm will create a Limited Partnership with the investors as LPs and the firm itself as the General Partner. Each "fund," or portfolio, is a separate partnership. A new fund is established when the venture capital firm obtains necessary commitments from its investors, say $100 million. The money is taken from investors as the investments are made. Typically, an initial funding of a company will cause the venture fund to reserve three or four times that first investment for follow-on financing. Over the next three to eight or so years, the venture firm works with the founding entrepreneur to grow the company. The payoff comes after the company is acquired or goes public. Although the investor has high hopes for any company getting funded, only one in six ever goes public and one in three is acquired.

Investors in Venture Capital Funds



*Source: **2004 NVCA Yearbook** prepared by Thomson Financial using 2003 data*

The Exit Funnel — Outcomes of the 11,686 Companies First Funded 1991 to 2000



** Of these, most have quietly failed*

Economic Alignment of all Stakeholders — An American Success Story

Venture capital is rare among asset classes in that success is truly shared. It is not driven by quick returns or transaction fees. Economic success occurs when the stock price increases above the purchase price. When a company is successful and has a strong public stock offering, or is acquired, the stock price of the company reflects its success. The entrepreneur benefits from appreciated stock and stock options. The rank and file employees throughout the organization historically also do well with their stock options. The venture capital fund and its investors split the capital gains per a pre-agreed formula. Many college endowments, pension funds, charities, individuals, and corporations have benefited far beyond the risk-adjusted returns of the public markets.

What's Ahead

Much of venture capital's success has come from the entrepreneurial spirit pervasive in the American culture, financial recognition of success, access to good science, and fair and open capital markets. It is dependent upon a good flow of science, motivated entrepreneurs, protection of intellectual property, and a skilled workforce.

The nascent deployment of venture capital in other countries is gated by a country's or region's cultural fit, tolerance for failure, services infrastructure that supports developing companies, intellectual property protection, efficient capital markets, and the willingness of big business to purchase from small companies.