Silicon Valley Venture Capitalist Confidence Index™

(Bloomberg ticker symbol: SVVCCI)

First Quarter – 2017

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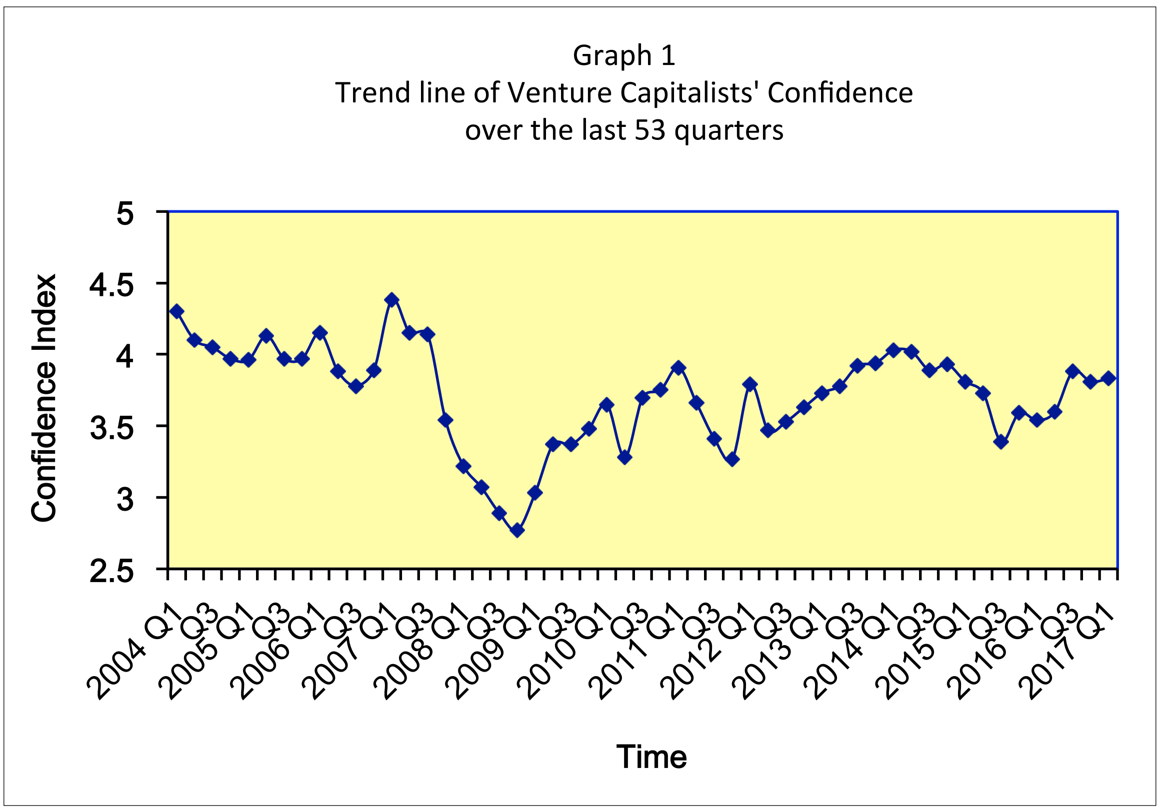
The *Silicon Valley Venture Capitalist Confidence Index™ (Bloomberg ticker symbol: SVVCCI)* is based on a recurring quarterly survey of San Francisco Bay Area/Silicon Valley venture capitalists. The *Index* measures and reports the opinions of professional venture capitalists on their estimations of the high-growth venture entrepreneurial environment in the San Francisco Bay Area over the next 6 - 18 months.[1] *The Silicon Valley Venture Capitalist Confidence Index™ for the first quarter of 2017, based on a March 2017 survey of 30 San Francisco Bay Area venture capitalists, registered 3.83* ***on a 5 point scale*** (with 5 indicating high confidence and 1 indicating low confidence). This quarter's index measurement is essentially unchanged from the previous quarter's index reading of 3.81, and still above the 13-year average of 3.72. Please see Graph 1 for trend data.



[1]Questions about this ongoing research study or related topics should be sent to Professor Mark Cannice at **Cannice@usfca.edu**.

Silicon Valley venture capitalists' confidence in the future high-growth entrepreneurial environment held steady in the first quarter of 2017, rising only slightly from the final quarter of 2016. However, the issues raised which substantiated VC confidence did adjust significantly. While the predominant focus in the final quarter of 2016 was on macro issues, particularly political uncertainty related to the U.S. election and various international issues, the primary emphasis in Q1 returned to more traditional venture issues, such as the rate of innovation, new market opportunities, and better exit expectations. This shift of attention toward industry issues should better support the high-growth entrepreneurial environment and portends a more promising 2017. Importantly, the amount of venture-backed exits, measured in terms of total capital value, rose significantly in Q1 from the previous and year-earlier quarters although the number of exits decreased.[2] This trend toward fewer larger exits is consistent with firms staying private longer and achieving higher valuations, thus, limiting the number of potential acquirers and crowding out some smaller deals. Meanwhile, the number of venture investments and new venture funds decreased.[3]

While the absolute metrics of the VC business model, namely, investments, exits, and fundraising, continue to adjust, VC confidence has remained relatively consistent quarter on quarter suggesting a general comfort level with industry trends and expectations. In the following, I provide many of the comments of the participating venture capitalist respondents along with my analysis. Additionally, all of the Index respondents' names and firms are listed in Table 1, save those who provided their comments confidentially.

Innovation is driving new opportunities that impact and even form new industries. Tim Draper of DFJ emphasized that "major exuberance is just beginning. Technology is transforming all the industries of the world." Eric Buatois of Benhamou Global Ventures specified "The digitalization of the enterprise is accelerating, creating more and more opportunities for young companies to grow very fast in the B to B space. The velocity of sales and marketing cycles leveraging the cloud and digital marketing techniques helps young companies to experiment and scale their customer base." Additionally, Cole Sirucek of Founders Equity Partners confirmed "Silicon Valley continues to advance with the underlying pace of innovation. That pace of innovation is strong. Technology advancements in AI, cyber security and the commercialization of space hold unique promise for the region…" And a venture capitalist respondent who provided commentary confidentially, noted that based on "30 years of experience, we seem to still be in an up cycle, and not euphoric."

Capital is available to fuel the current innovation cycle. One VC respondent asserted "Foundational resources to start a company are more available than ever. The funding environment is ripe. There is significant VC overhang; lots of funds were raised in 2016 that need to deploy in 17 and 18." And Bill Byun of 7 Capital observed that the "number of quality deals for consideration is increasing."

Exit opportunities appear to be improving. Sandy Miller of Institutional Venture Partners stated "We are off to an excellent start in what should be the best IPO market in many years. The first IPOs done this year have worked well and there is a large number of super high-quality companies that are already on file confidentially that are poised to go public. This will give much needed liquidity to the venture capital ecosystem and is long overdue." Another venture capitalist contributor highlighted "exuberant public markets." However, views on liquidity vary as Kurt Keilhacker of Elementum Ventures reported "Venture formation continues at a steady clip. Yet, exit opportunities are slower than most anticipated."

Silicon Valley continues to be the center of entrepreneurial opportunity. Jeb Miller of Icon Ventures explained "The Bay Area continues to benefit from abundant sources of capital and an improving exit environment with quality IPOs performing well and robust strategic alternatives as vulnerable incumbents

[2] PitchBook-NVCA Venture Monitor Report Q1 2017
[3] PitchBook-NVCA Venture Monitor Report Q1 2017

continue to acquire innovation. We are particularly excited about the opportunity to build disruptive and capital efficient vertical market and functional applications that leverage the wealth of technologies that have been advanced in the analytics, machine learning, AI, cloud and mobile stacks."

Cautious optimism is still in order. Bill Reichert of Garage Technology Ventures wrote "Silicon Valley's innovation energy is being distributed across a broader and broader base of opportunities. Although there is still plenty of exuberant overvaluation in some areas, there is no single point of failure internally, as there was in past bubbles. Externally, the key threat is the macro environment. The unexpectedly good performance of U.S. and global markets has sustained the positive outlook for the Valley, but this could reverse quickly." Dixon Doll of Impact VC said the "outlook depends on several key factors…committed capital, macroeconomic outlook, exit environment (can VC's realize their paper gains, etc.?) The only major negative I see now is a lousy IPO market (partially offset by a quite strong M&A environment). Dr. Doll continued, saying "Positives are a historically high amount of committed capital, a strong entrepreneurial talent pool in the Bay Area, and a strong potential for new technologies like cloud, AI, VR, data analytics, etc."

Valuations are in motion. Bob Ackerman of Allegis Capital relayed "Markets continue to recalibrate after a 7-year bull run. While innovation continues apace, the financing bar has been raised yet again with investors looking for more validation in support of valuations at all stages of start-up development. While painful, the process will result in a healthier start-up environment going forward." Bob Bozeman of Eastlake Ventures, validated this trend, noting, "We're in a resolution phase: from the over-priced to the rationalization stage." And Gerard van Hamel Platerink of Redmile Group indicated that "healthcare valuations continue to descend to more sensible levels although slower than we expected. There continues to be an element of 'extend and pretend' in some deals with insider bridging or 'round extensions' to lengthen runway. The result is the same – healthcare investors will likely get better value in 12 months compared to today." One other respondent pointed to the "gap between seed and Series A valuations."

Howard Lee of Founders Equity Partners reasoned "There is continued volatility in company valuations. In an uncertain IPO market, many companies are currently trying to retain their best employees as well as manage employee expectations…Combined with companies remaining private for longer periods of time compared to the past, we expect this trend to continue even if the IPO market improves towards the end of 2017." Cole Sirucek of Founders Equity Partners added "As these companies stay private longer, solutions to meet employee needs for liquidity has become an important pain point in need of corresponding financial innovations."

Macroeconomic and policy issues continue to influence sentiment. John Malloy of BlueRun Ventures cautioned "Silicon Valley innovation remains a long-term strength but protectionism is a worrying trend." Dag Syrrist of Vision Capital contended that the "lack of visibility and predictability out of DC, rising interest rates, cooling equity markets, all will favor a wait & see attitude by investors." Bob Pavey of Morgenthaler Ventures offered "Trump may be great or he may not. Who knows, but I choose to be optimistic." Another VC respondent projected "A strong economy with rising consumer confidence will mean stability (corrections may occur, but no bear market) in the public equity markets notwithstanding the elevated valuations. This will be a market that can absorb technology IPOs, and that liquidity will encourage further investment in Silicon Valley. If tax reform can be passed this year, then there will be an added boost to the technology sector, particularly if there is some relief on repatriating cash. Tech companies have large pools of overseas cash, and even though large amounts of that have already been invested in Silicon Valley through intercompany lending, there will still be an added boost to lowering the tax rates here in the U.S. and repatriation of cash that has not been loaned for investment in the U.S. already."

Mohanjit Jolly of Iron Pillar concluded “Despite some political and policy uncertainty, the entrepreneurial ecosystem is thriving, both on the ingress (innovation) front as well as the egress (exit) front. The euphoria around technologies like AI, AR/VR, NLP/Voice and connected everything is palpable. Successful tech entrepreneurs are launching their subsequent ventures, and both financial and mentor/advisory capital is in ample supply. Finally, global entrepreneurs are flocking to the US either to launch their ventures here, or soon after launching in their local geographies.”

In summary, Silicon Valley venture capitalists’ confidence remained constant from the previous quarter while the issues that drove that confidence varied considerably. For example, while some consideration of the broader macro and political environment did persist in Q1, focus returned to the fundamentals of the venture business with particular attention paid to current and expected cycles of innovation and the new market opportunities the cycles are creating. While valuations appear somewhat volatile as the exit market outlook remains opaque, available capital is abundant for disruptive ventures that leverage emerging technologies to challenge industry incumbents. This disruptive pressure will cause legacy industry participants to purchase innovation proactively and reactively, supporting the M&A environment, and ultimately the IPO cycle as acquisition bids underpin confidence in public market offerings.

Thus, the Silicon Valley engine appears to again be laser-focused on core technology innovation, market disruption, and value creation, allowing the macro surprises of the previous quarter and ongoing domestic and international uncertainties to gradually recede to the background of the entrepreneurial environment. As economic value is being increasingly digitally concentrated by new technology-enabled business models, the venture ecosystems of Silicon Valley and elsewhere remain the destination of high-expectation capital and visionary entrepreneurs.

Table 1

Participating Venture Capitalists in the 2017 1st Quarter Confidence Index Survey

Participant	Company
Benjamin Bayat	Illuminate Ventures
Bill Byun	7 Capital
Bill Reichert	Garage Technology Ventures
Bob Bozeman	Eastlake Ventures and NCIF I&II
Bob Pavey	Morgenthaler Ventures
Cardinal Partners	Cardinal Partners
Cole Sirucek	Founders Equity Partners
Dag Syrrist	Vision Capital
Dan Lankford	Wavepoint Ventures
Deepak Kamra	Canaan Partners
Dixon Doll	Impact VC and DCM Ventures
Eric Buatois	Benhamou Global Ventures
Gerard van Hamel Platerink	Redmile Group
Howard Lee	Founders Equity Partners
Jeb Miller	Icon Ventures
Jeremy Liew	Lightspeed Venture Partners
John Malloy	BlueRun Ventures
Jon Soberg	Expansive Ventures

Karan Mehandru	Trinity Ventures
Kurt Keilhacker	Elementum Ventures
Mohanjit Jolly	Iron Pillar
Richard Yen	Saban Capital Group
Robert R. Ackerman, Jr.	Allegis Capital
Sandy Miller	Institutional Venture Partners
Shomit Ghose	Onset Ventures
Standish O'Grady	Granite Ventures
Stephen J. Harrick	Institutional Venture Partners
Tim Draper	DFJ
Anonymous	Anonymous
Anonymous	Anonymous

Mark V. Cannice, Ph.D. is Department Chair and Professor of Entrepreneurship and Innovation with the University of San Francisco School of Management. The author wishes to thank the participating venture capitalists who generously provided their expert commentary. Thanks also to Jack Cannice and James Cannice for their copy-edit assistance. When citing the index, please refer to it as: *The Silicon Valley Venture Capitalist Confidence Index*™, and include the associated Quarter/Year, as well as the name and title of the author.