PRIVATE EQUITY PARTNERS | MARKET UPDATE

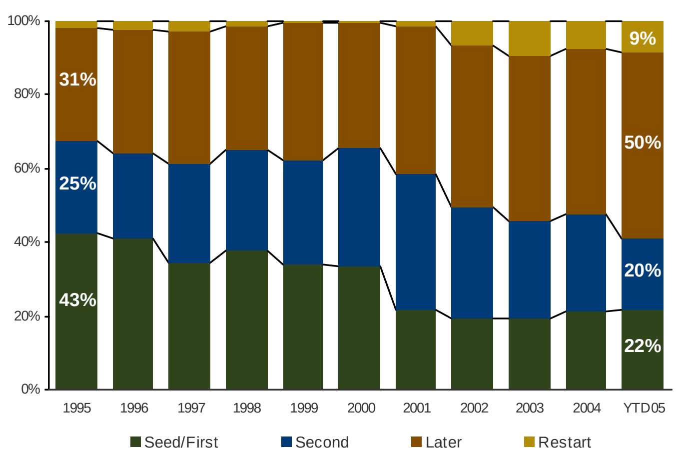
November 2005

Parsing Venture Fundraising Data – *where have the seed stage investors gone?*

Most of us are aware that buyout funds have been inundated with new capital from investors. Investors' appetites for alternative assets like venture capital and buyouts and the prospect of high returns have returned now that the worst of the "New Economy" boom and bust is behind us. Many well-established buyout firms recently raised multi-billion dollar funds that are 50-100% larger than their previous efforts. Several more of such firms are poised to do the same in early 2006. Even emerging buyout managers have fared well on the fundraising trail.

While buyout firms today see tremendous new opportunities to deploy capital globally, U.S. venture firms seem almost out of synch by comparison. We, of course, are thankful for the self-restraint that many top tier VC firms have demonstrated by raising smaller funds despite swelling demand by their investors. Note that 2005 VC fundraising is on an $18 billion pace, which is roughly equivalent to 2004 and far below the record of $83 billion raised in 2000. Reducing fund sizes to match the post-bubble economy is appropriate; however, we have noticed that many well-established VC firms also have gravitated to later stage deals that offer the opportunity to more efficiently put capital to work. Approximately 50% of venture dollars in Q1-Q3 of 2005 went to late stage deals, compared to just 31% in 1995. The percentages are worse if you include restarts: 59% in 2005 vs. 32% in 1995. Alternately, precious few dollars are being allocated to seed stage. While pure seed stage numbers are hard to isolate, we know that approximately 22% of venture dollars in the first three quarters of 2005 went to seed and early stage deals, down significantly from 43% in 1995. This shift began to emerge (post-bubble) in 2001 (see chart).

Investment Allocation by Round Class



Source: Dow Jones/Venture One, Ernst & Young

For some, this data may beg the question: if everyone insists on doing late stage deals, who will fund the seed stage deals to keep priming the pump? We think this is a temporary, cyclical imbalance reflecting a dearth of bidders for seed stage deals. In parsing the data, we found that the median pre-money valuations for seed stage deals are incredibly low at just $2.0 million for the first half of 2005, compared to $1.8 million in 1995 and $5.0 in 2000. (compared to late stage median valuations of $24.4, $89.8 and $32.0 million in 1995, 2000 and 2005, respectively) There is no reason to assume that the quantity or quality of new business opportunities has changed so significantly. Instead, we believe this indicates that there is relatively little competition for seed stage deals. Historically a significant portion of seed stage funding has come from emerging managers. Post-bubble, few emerging managers have been able to raise venture funds due to their lack of track record. Meanwhile, as eluded to earlier, successful seed stage firms have often evolved into bigger funds as their success is rewarded with more investor demand, resulting in a shift to bigger later stage deals. Eventually, we believe this situation will be corrected. One possible fix is that certain partners from well-established later stage funds will launch new seed stage funds to fill this market void. Their investment track records will cultivate the institutional investor confidence that a new emerging manager cannot gain.

It is our job as fund of funds managers to identify those venture capitalists that recognize these imbalances early and act accordingly. As always, we welcome your questions and comments.

*Piper Jaffray was established in 1895 and has grown to become a nationally and internationally recognized firm serving growth companies and growth company investors. We have a significant commitment to alternative assets through our series of fund of funds, **Private Equity Partners**, and anticipate offering our next fund, **Private Equity Partners III,** in early 2006.*

Private Equity Partners

Investment Professionals

Dan Donoghue
312 920-2132
daniel.j.donoghue@pjc.com

Scott Barrington
612 303-1110
scott.l.barrington@pjc.com

Edward Ray
612 303-5690
edward.k.ray@pjc.com

Jonathan Seltzer
612 303-0410
jonathan.c.seltzer@pjc.com

Seth Trier
612 303-6674
seth.r.trier@pjc.com

Fund Administration

Gretchen Postula
612 303-6331
gretchen.s.postula@pjc.com

Susan Swift
312 920-2153
susan.e.swift@pjc.com

Private Capital Group

800 Nicollet Mall
MS: J09N03
Minneapolis, MN 55402

Hyatt Center, 24th Floor
71 South Wacker Drive
Chicago, IL 60606-4616

Find us on the web at
piperjaffray.com/fundoffunds