THE BUSINESS ENVIRONMENT FACING EMERGING COMPANIES TODAY

A Report Presented By:

Foley & Lardner LLP

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TABLE OF CONTENTS

Executive Summary

As emerging companies and their investors continue to grapple with mixed economic indicators, Foley & Lardner LLP once again commissioned its annual survey of the business environment facing emerging companies today.

Key findings and themes from our 6th annual survey include:

The investor community is demonstrating a preference for quick and safe investments, while emerging companies are experiencing greater difficulty closing ''B'' round funds.

- An overwhelming majority of respondents (80 percent) agreed that investors prefer quick / safe investments and smaller returns, as opposed to risky bets on companies that could generate a significant return.
- A majority of respondents (62 percent) also agreed that emerging companies are experiencing greater difficulty closing “B” round funds as opposed to “A” rounds. The 38 percent who disagreed with this statement indicated in verbatim responses that “A” rounds are more difficult to secure.
- We believe these findings are indicative of a fundamental shift in the venture capital paradigm as investors are less willing to make risky investments and are instead focused on smaller, more predictable returns.
  - As investors focus on quick in-and-out companies and safer returns, we’ve witnessed a preference for “A” round investments that require less capital and carry the potential for large returns, as well as late round investments (i.e. “C” or “D” rounds) that are safer as they require less capital and generate predictable, smaller returns. In today’s marketplace, investors are less likely to complete a “B” round investment as it generally requires more capital with the potential for only moderate returns.

Emerging company executives are actively hiring and are optimistic in forecasting hiring plans.

- A high percentage of executives indicted hiring both full-time (39 percent) and part-time (45 percent) employees in the last 12 months, as well as exploring alternatives to full time employment (47 percent).
- Executives were also optimistic in forecasting their hiring plans over the next 12 months, with 47 percent planning to hire one to four full-time employees and 31 percent expecting to hire five or more.

Emerging company executives are continuing to rely on the M&A market as their primary exit strategy as the influence and prevalence of strategic buyers remains strong in today's market.

- Similar to previous years, the majority of executives (58 percent) indicated a merger or sale as their likely exit strategy.
- Consistent with data from our 2009 survey, the overwhelming majority of respondents agreed that strategic buyers are more active than at any point over the past five years (68 percent) and emerging company business plans are influenced by the needs of strategic buyers (82 percent).
- The majority of emerging company executives (57 percent) agreed that they're tailoring growth to strategic buyers, however to a lesser extent than those expressing agreement in 2009 (71 percent). We believe this shows that emerging company executives are influenced by strategic buyers, but not tailoring their growth to the same degree.

Although economic conditions are improving, emerging company executives are continuing to experience difficulty raising capital.

- Consistent with data from previous surveys, the majority of emerging company executives sought or obtained capital within the past year (69 percent) and are planning to do so again within the next year (63 percent).
- Of the executives who recently sought or obtained capital, 82 percent expect to again seek capital within the next year. We believe that this higher percentage compared to the average respondent suggests that these executives are continuing to experience difficulty raising capital.
- In response to economic conditions, executives indicated extending their timeframe in an effort to raise capital (45 percent) and seeking capital from alternative sources (39 percent).
- On the positive side, respondents expressed very optimistic predictions for emerging company valuations and access to capital. Over the next two years, 83 percent expect emerging company valuations to grow and 69 percent predict access to capital will improve.

Executives, advisors and investors do not view the IPO market as a viable exit strategy, but are expressing signs of optimism.

- Although executives again indicated an overall reluctance to test the IPO market, this year's survey saw a slight increase of respondents citing an IPO as their likely exit strategy (five percent).

- While respondents continue to predict a stagnant IPO market (77 percent), we've seen a steady increase in predictions for a robust IPO market over the next two years (1 percent in 2008 to 18 percent in 2010).
- According to Hoover's IPO Scorecard, 30 U.S. companies went public in the third quarter of 2010. This represents a dramatic increase in comparison to companies that completed an IPO in Q3 2009 (17) and Q3 2008 (5). We see this data, combined with the increase in respondents predicting a robust IPO market, as a sign of optimism.
  - It is interesting to highlight that these 30 companies raised an aggregate of $4.7 billion which is significantly less than the $5.5 billion raised by the 17 companies who went public in Q3 of 2009.

VERBATIM RESPONSES

Do you agree or disagree with the following statement?

Because of the current emphasis by investors on “A” round funding, it is now easier for a new company to obtain funding than it is for an established company to find additional capital.

Disagree

- Investors are looking for an established revenue stream and are more likely to find it in an established company.
- “A” rounds have been more difficult to complete in the last two years. “B” rounds have been easier because they are typically existing investors protecting their “A” round money, at a down-round valuation, or modest uptick.
- There is some increase in "A" financings, but there is still a reluctance to fund new teams with new ideas. Investors are focused on investing with people they know, and in ideas where the exit is well mapped out in advance. There is little appetite for innovative ideas that need to have proof of concept established.
- People don't seem as willing to invest in start-ups that have no track records. Established companies on the path to a sale or acquisition is a surer bet.
- Finding Series “A” funding is still very difficult. Investors are extremely risk adverse and many aren't even interested in a first meeting.

Agree

- My experience proves this out. Investors seem more interested in taking a risk on something new rather than putting additional capital against a business that might have stalled due to the economy.
- An established company with solid growth and great potential seems to be having more trouble raising capital than startups with big promises but no history.
- True only in the sense that “A” rounds are smaller and therefore less capital is at risk. More opportunities for diversification into multiple promising companies with low valuations.
- Established companies are being scrutinized at much higher levels and traditional sources of growth capital (i.e. banks) are being much more cautious as to lending and their requirements are much stricter. Couple this with the general lack of capital made available for lending and you start to see the problem. “A” Round is still examined very closely,

however the lack of actual results and the basis for lending being the future potential, there is much more room for varying opinions on valuation.

What is your perception of alternative (non-VC or non-strategic VC investing) sources of equity that are currently active in the market today?

- Angels and super angels with "A" round financing have been instrumental in the launching of new companies during the last two years.
- Less interested in providing greater amounts of funding. They want more equity for less invested dollars. This makes this arena less attractive as they devalue your company.
- Alternative investors have become both more active and more attractive than VC firms. Less herd mentality as a result of more specific, individual agendas than VC firms.
- Alternative forms of funding are becoming more prevalent - but access to these funding sources is not as widespread.
- They are becoming a key source of funding for early stage companies – as VC funding has pulled back and as the overall number of VC firms have fallen secondary to VC industry consolidation.
- The only realistic way for most early stage startups to raise capital.
- Angels are acting as VCs were five -10 years ago. Nothing is filling the gap. Early stage funding is increasingly hard to get.
- Willing to take reasonable risk, but expecting a larger percentage of the company.
- It is a great resource for low capital intensive companies. A company with strategic angel investors is well positioned to maximize its potential. If done well, growing the core business engine prior to large user acquisition spend, provides more avenues when considering future growth options.

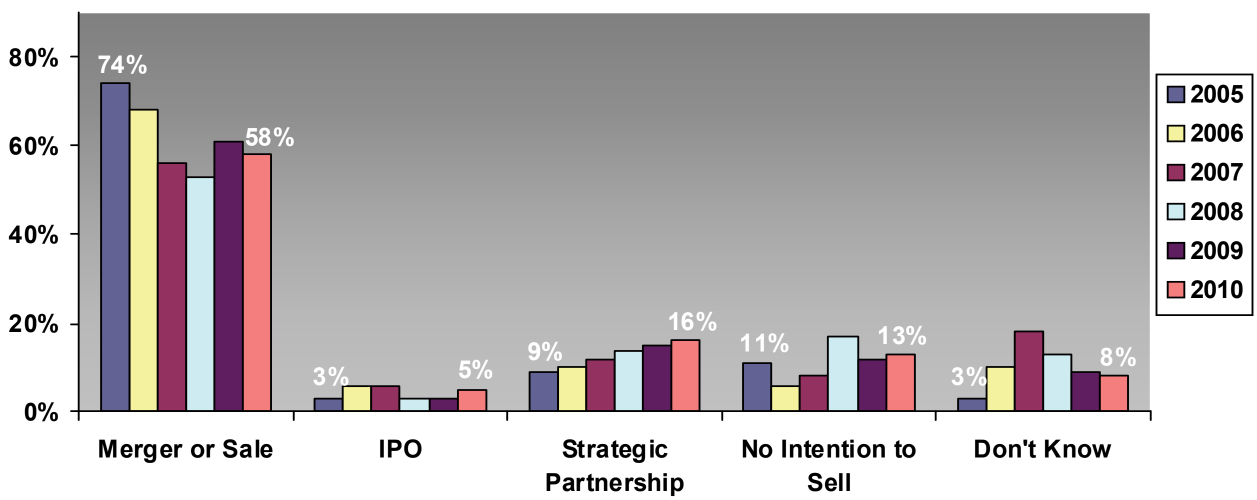
ANALYSIS OF EMERGING COMPANY SURVEY

Perspective From Executives of Emerging Companies

The following questions reflect input received from respondents who currently serve as executives of emerging companies.

What is your likely exit strategy?

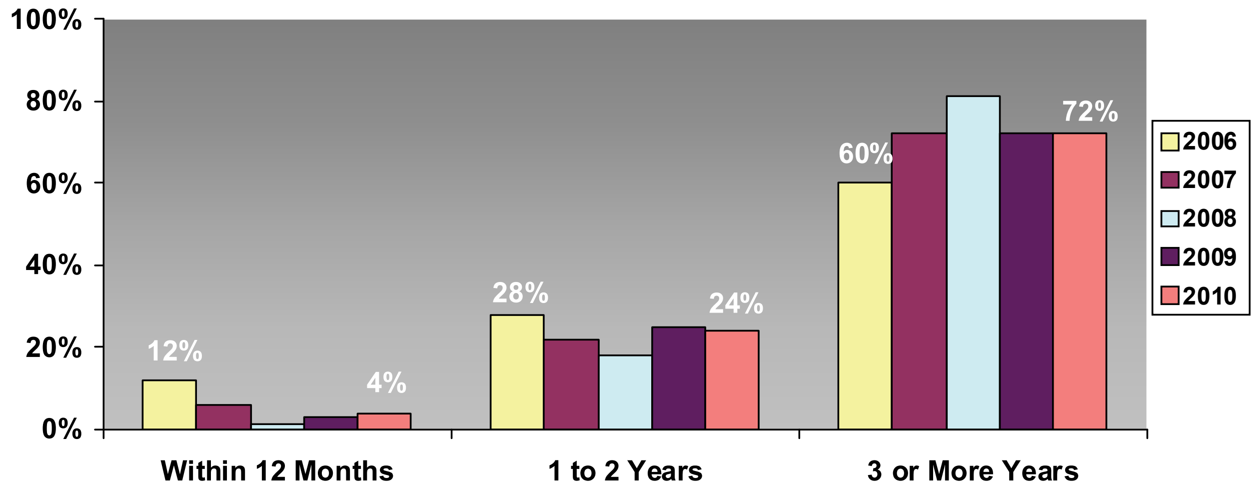
(This question was only addressed to respondents who identified themselves as a "founder or executive of an emerging company")



- Emerging company executives are continuing to rely on the M&A market as their primary exit strategy. Similar to previous years, the majority of executives (58 percent) indicated a merger or sale as their likely exit strategy.
- Since 2005, the number of emerging company executives citing a strategic partnership as their likely exit strategy has steadily increased.
- Although executives again indicated a reluctance to test the IPO market, this year's survey saw a slight increase with five percent citing an IPO as their likely exit strategy.

What is your likely timeframe for an exit?

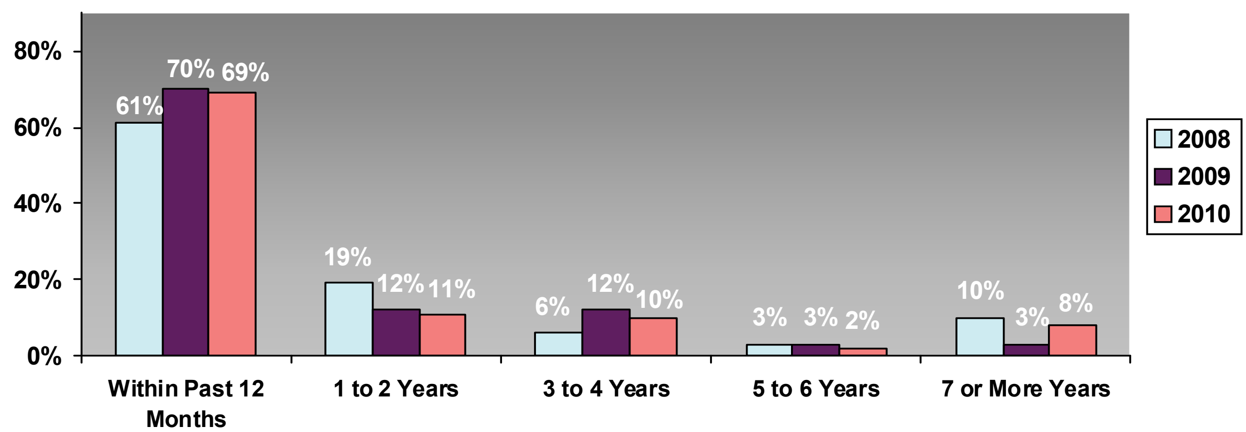
(This question was only addressed to respondents who identified themselves as a "founder or executive of an emerging company")



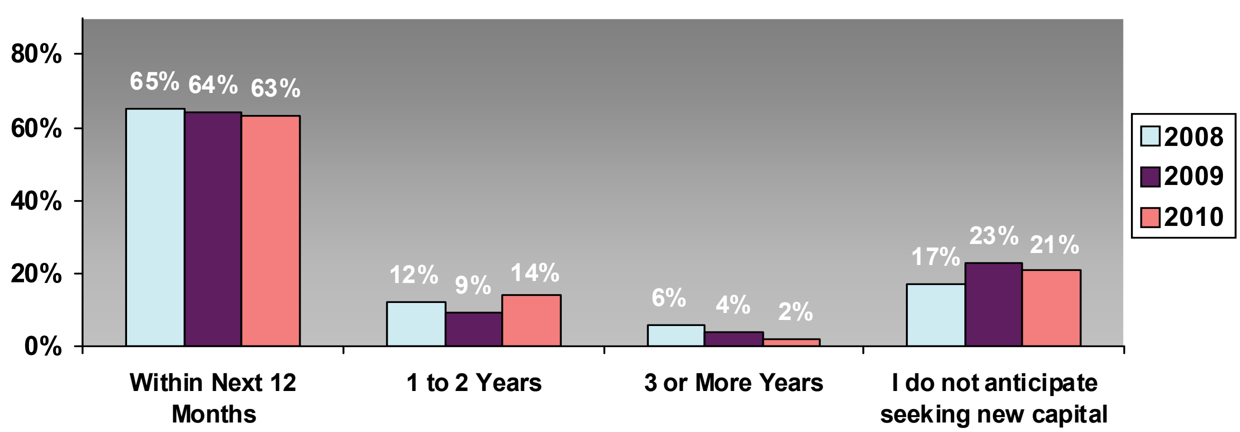
- Despite signs that the economy is stabilizing, most executives continue to anticipate a lengthy timeframe for an exit.
- In comparison to 2005 when 60 percent of executives were at least three years from an exit, emerging company executives have continued to extend their exit timeframe over the past five years.

(These questions were only addressed to respondents who identified themselves as a "founder or executive of an emerging company")

When did you last seek or obtain a capital infusion for your business?



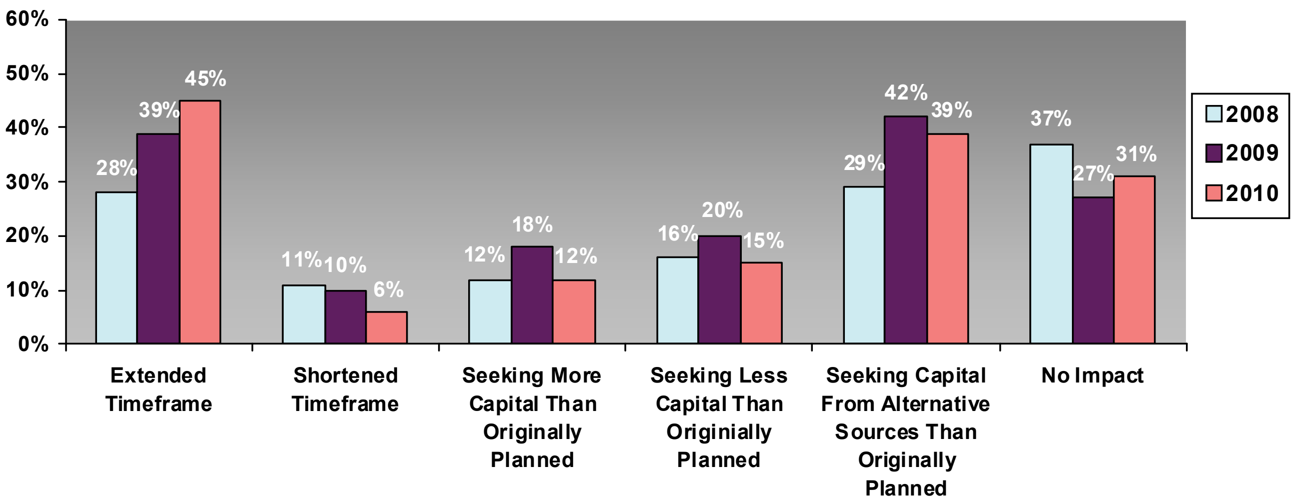
When do you next expect to seek a capital infusion for your business?



- Consistent with data from previous surveys, the majority of emerging company executives sought or obtained capital within the past year (69 percent) and are planning to do so again within the next year (63 percent).
- Of the executives who recently sought or obtained capital, 82 percent expect to again seek capital within the next year. We believe that this higher percentage compared to the average respondent suggests that these executives are continuing to experience difficulty raising capital.

How have current economic conditions impacted your plans to raise capital?

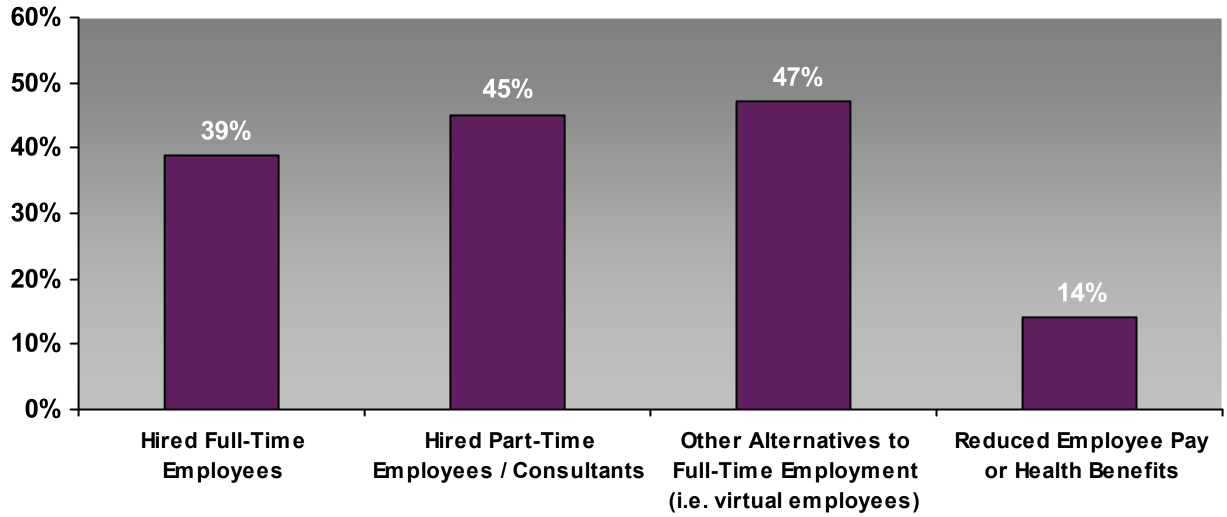
(This question was only addressed to respondents who identified themselves as a "founder or executive of an emerging company")



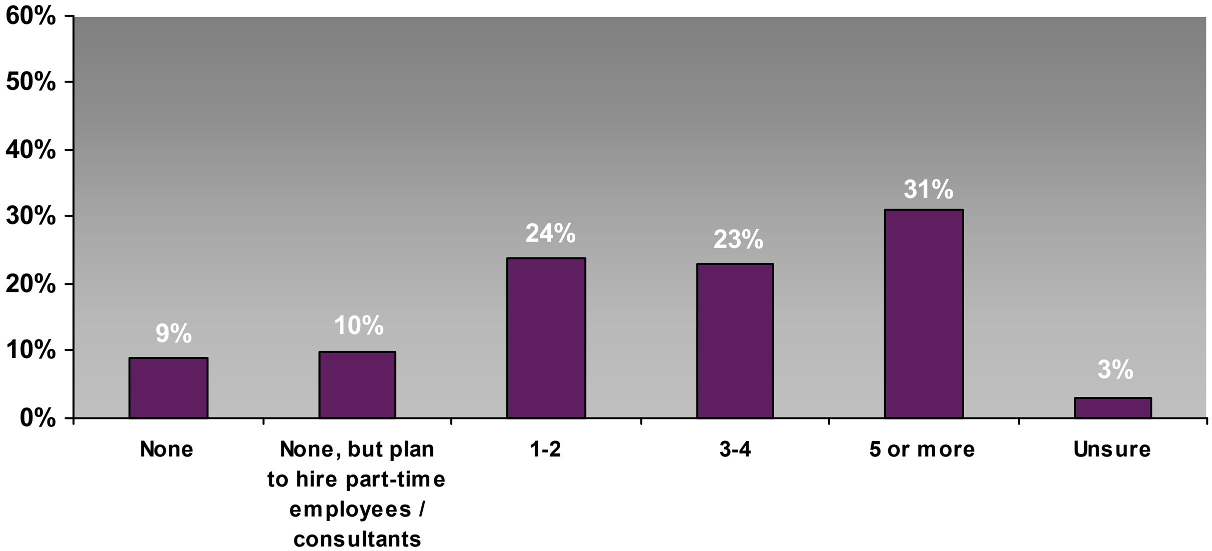
- Our 2010 survey saw a significant increase in executives extending their timeframe in an effort to raise capital from 2008 (28 percent) to 2010 (45 percent)
- In addition, current economic conditions have led 39 percent of responding executives to seek capital from alternative sources. When asked about their perception of these alternative sources, executives expressed varied opinions on their role in funding emerging companies, including:
  - "a great resource for low capital intensive companies"
  - "more prevalent but access is not as widespread"
  - "acting as VCs were five -10 years ago"
  - "the only realistic way for most early stage companies to raise capital"
  - "less interested in providing greater amounts of funding"
- Of the executives who chose "no impact" (31 percent), 24 percent indicated having "no intention to sell" when asked about their current exit strategy (compared to 13 percent of executives overall) and 50 percent do not expect to seek a capital infusion (compared to 21 percent of executives overall). Thus, we believe these executives are not experiencing an impact on plans to raise capital because they are less actively seeking an exit or capital infusion.

(These questions were only addressed to respondents who identified themselves as a “founder or executive of an emerging company”)

Have you done any of the following with your workforce in the last 12 months?



How many full-time employees do you plan to hire in the next 12 months?

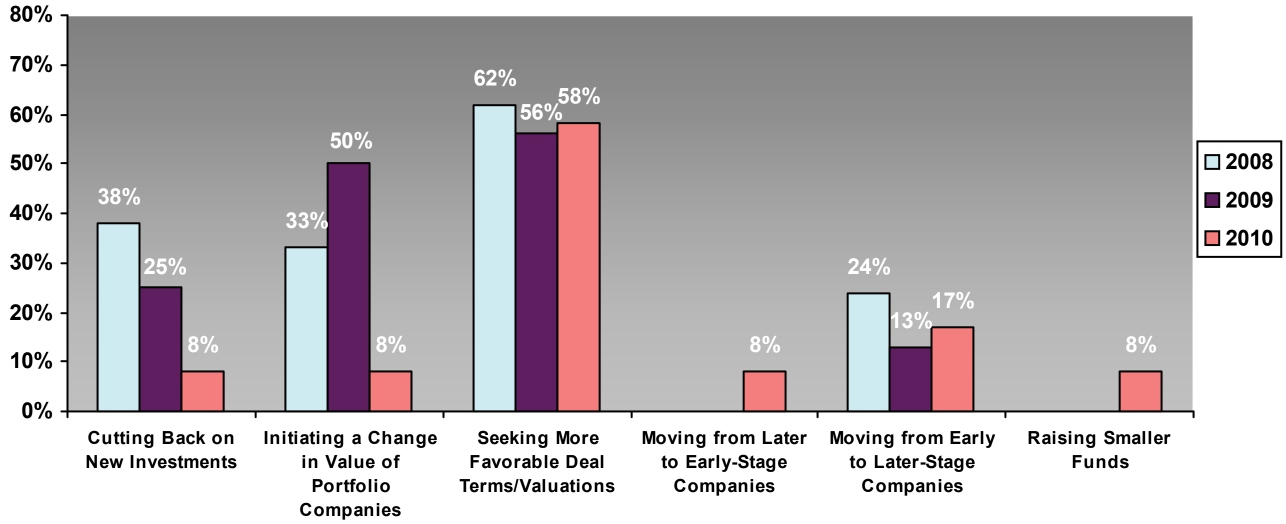


- Consistent with recent data revealed by several of the major accounting firms, emerging company executives are actively hiring and are optimistic in forecasting hiring plans.
- Emerging company executives have been actively hiring both full-time (39 percent) and part-time (45 percent) employees in the last 12 months, as well as exploring alternatives to full time employment (47 percent).
- Executives were also optimistic in forecasting their hiring plans over the next 12 months, with 47 percent planning to hire 1-4 full-time employees and 31 percent expecting to hire five or more.

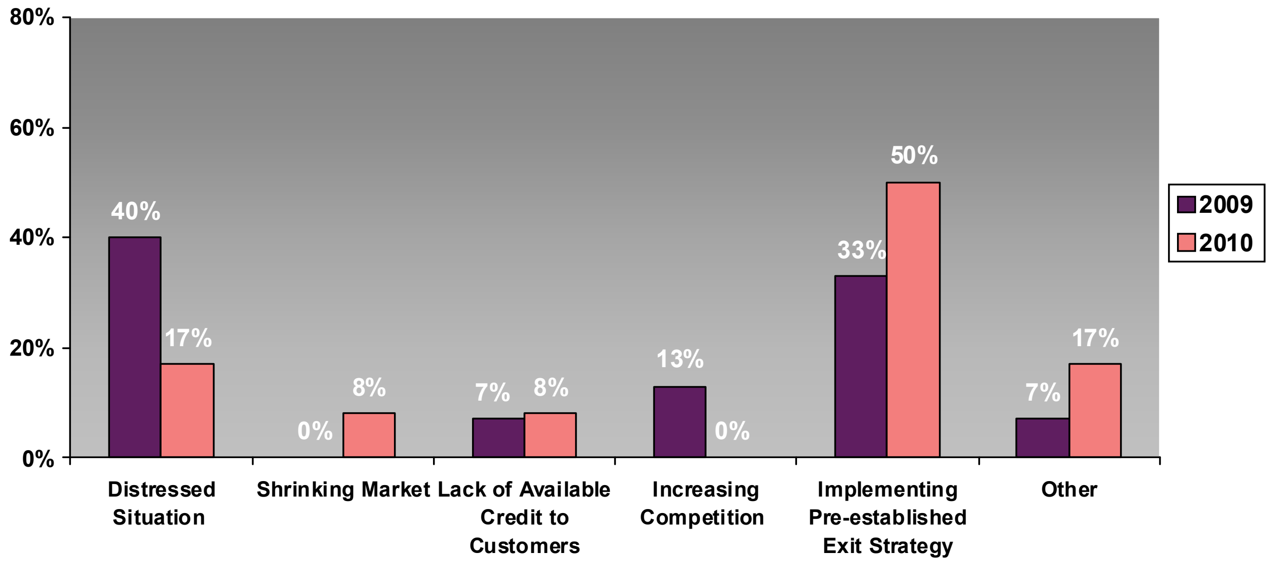
PERSPECTIVE FROM INVESTORS IN EMERGING COMPANIES

The following questions reflect input received from respondents who actively invest in emerging companies.

In light of current economic conditions, are you conducting any of the following activities?



Of the following options, which are you seeing most frequently as a motivation behind a company's decision to sell?

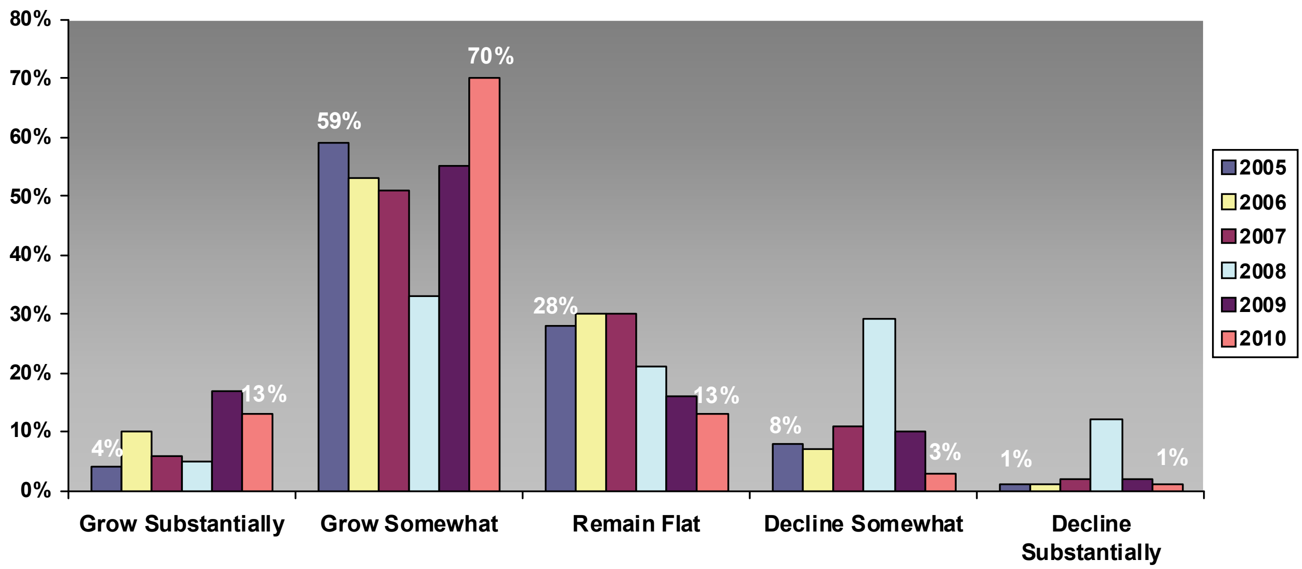


- Similar to previous years, investors are continuing to take the opportunity to leverage current economic conditions to obtain more favorable deal terms and valuations (58 percent).
- In comparison to 2009 data, investors seem to sensing a shift in a company's motivation to sell from a distressed situation (40 percent in 2009 to 17 percent in 2010) to implementing a pre-established exit strategy (33 percent in 2009 to 50 percent in 2010).
- Note that while the number of responding investors (6 percent of total respondents) is too small to draw definitive conclusions, the above trends are consistent with what we're seeing in the marketplace.

PERSPECTIVE FROM ALL RESPONDENTS

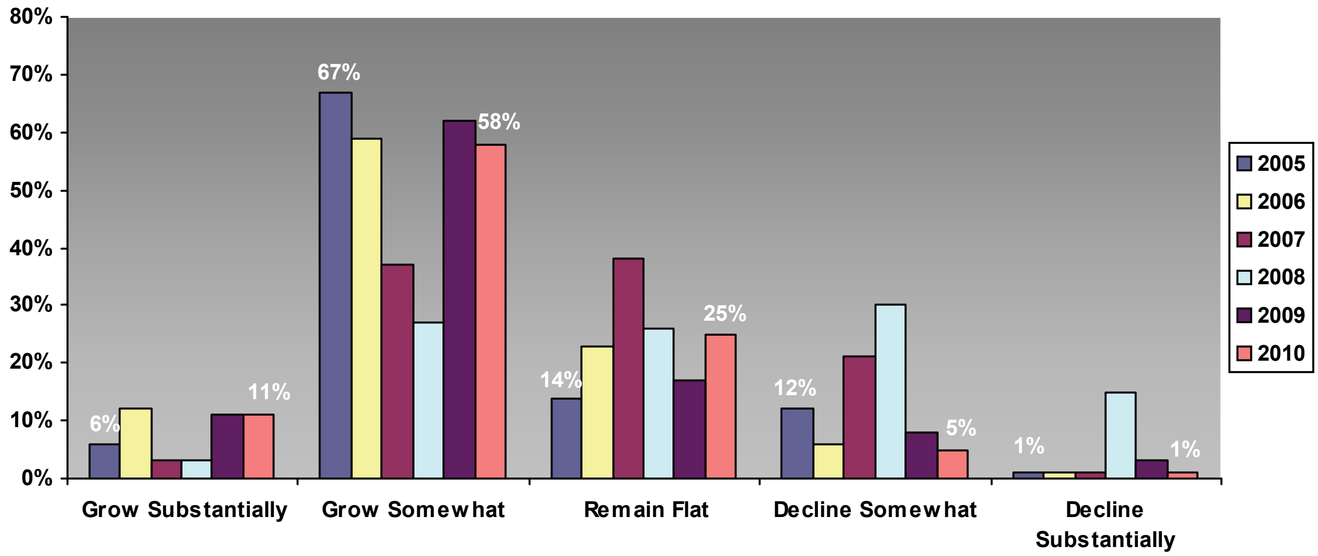
The following questions reflect input received from all 198 respondents.

Over the next two years emerging company valuations will:



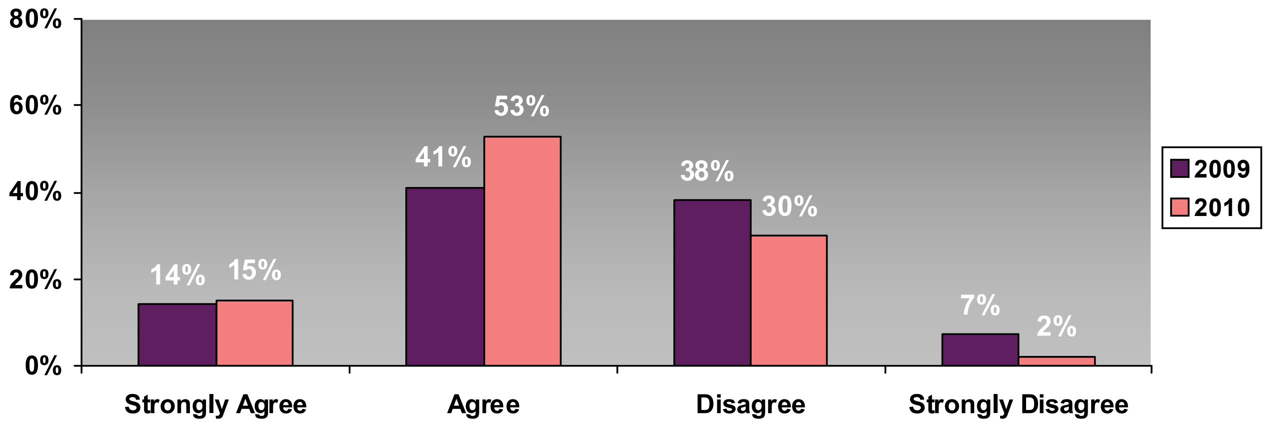
- On the heels of strong predictions for emerging company valuations in 2009, respondents expressed even more optimistic forecasts in 2010.
- 83 percent of respondents now expect emerging company valuations to grow over the next two years, compared to 38 percent in 2008 and 72 percent in 2009. Furthermore, only 4 percent of respondents anticipate a decline, compared to 41 percent in 2008 and 12 percent in 2009.

Over the next two years access to capital will:

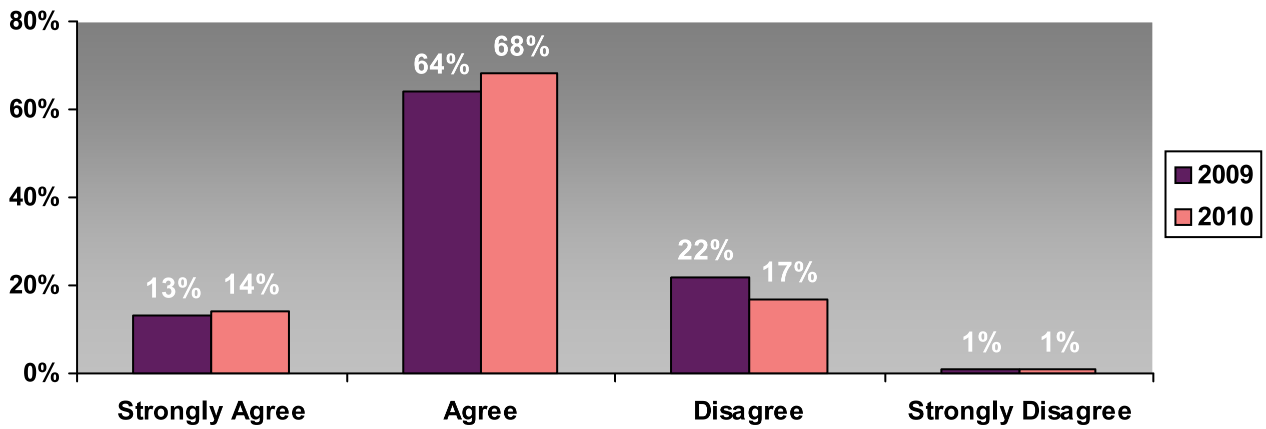


- The majority of respondents (69 percent) continue to believe access to capital will improve over the next two years, however predictions were slightly less optimistic than for valuations.
- While respondents were extremely pessimistic in regards to access to capital in 2008 (45 percent anticipated a decline), our 2009 and 2010 surveys saw a significant turnaround with only 11 percent and 6 percent, respectively, expecting a decline.

To what extent do you agree with this statement: In today's market, strategic buyers are more active than at any point over the past five years.

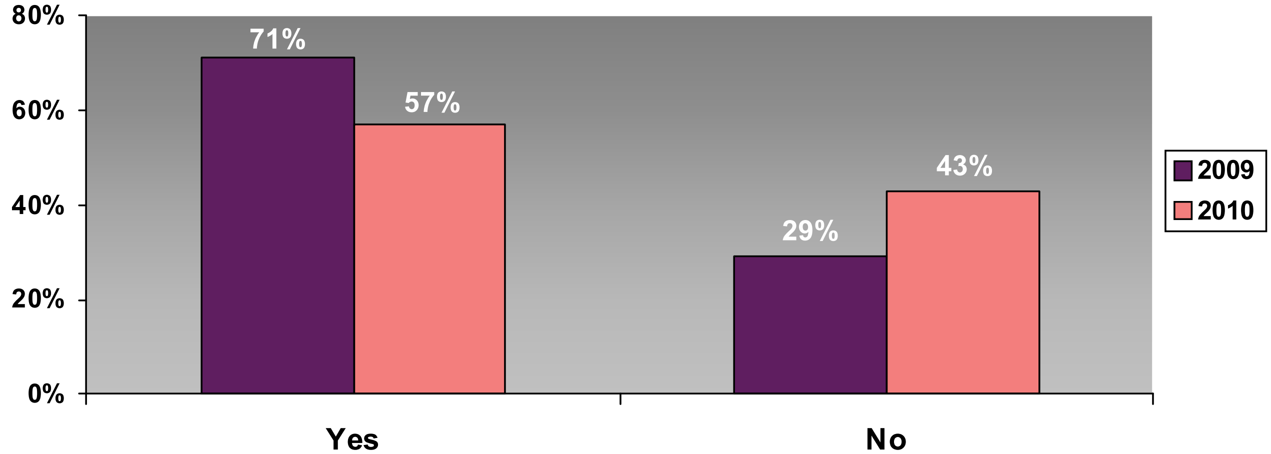


To what extent do you agree with this statement: The business plans of today's emerging companies are influenced by the known needs of strategic buyers.



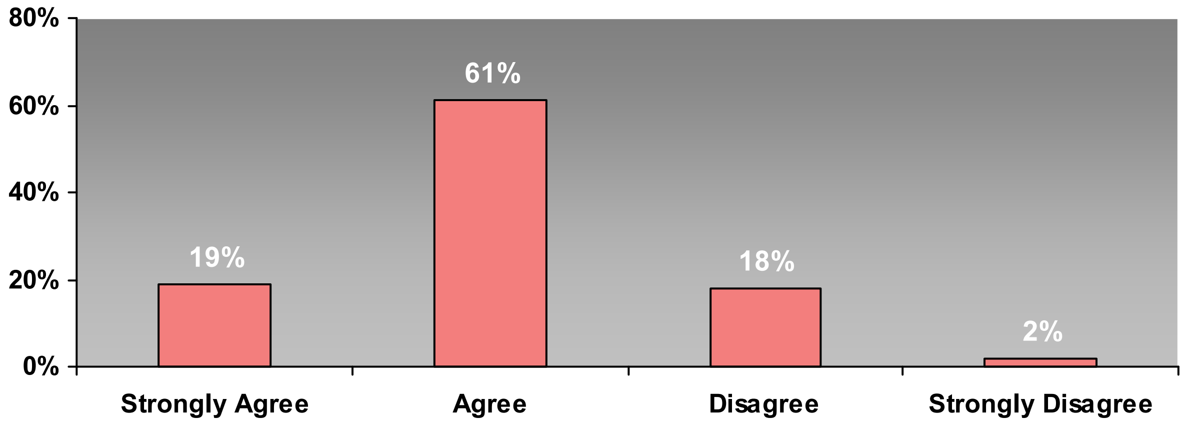
Are you in any way tailoring your growth to fit the expectations of strategic buyers?

(This question was only addressed to executives of emerging companies.)

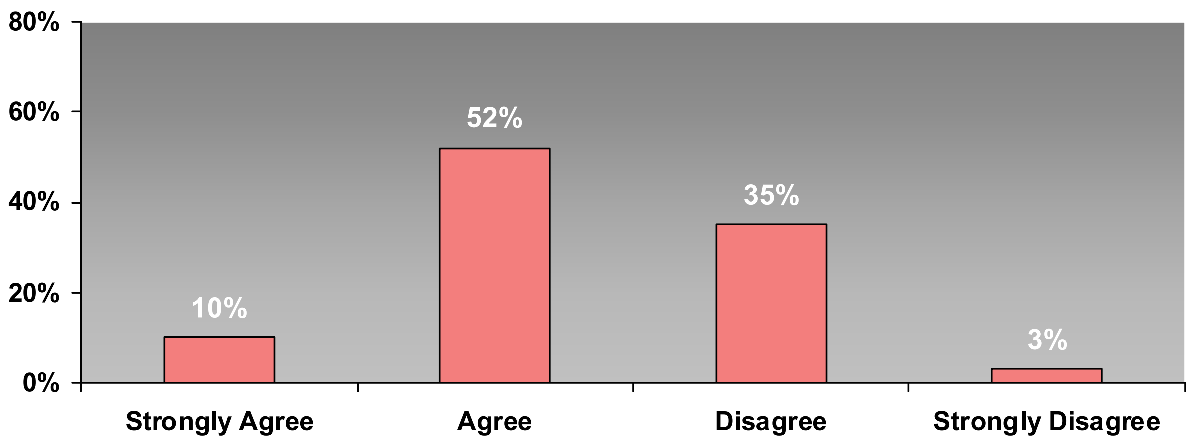


- Similar to our 2009 survey, respondents again acknowledged the presence and impact of strategic buyers in today's market. The overwhelming majority agree that strategic buyers are more active than at any point over the past five years (68 percent) and emerging company business plans are influenced by the needs of strategic buyers (82 percent).
- While the majority of executives (57 percent) indicated tailoring their growth to strategic buyers, this represents a decrease from the 71 percent of executives who expressed agreement with this statement in 2009. We believe this shows that emerging company executives are influenced by strategic buyers, but not tailoring their growth to the same degree. With the private equity market resurging, executives seem to recognize the importance of strategic buyers as one of many viable exit strategies.

To what extent do you agree with this statement: In today's market, investors prefer quick / safe investments and smaller returns, as opposed to risky bets on companies that could generate a significant return.



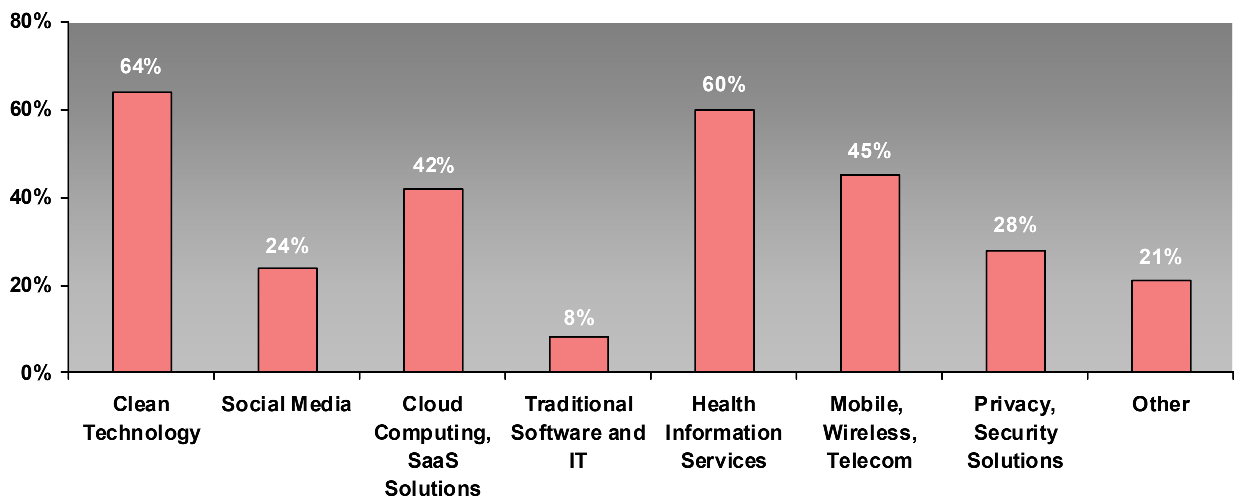
To what extent do you agree with this statement: Today's emerging companies are experiencing greater difficulty closing "B" round funds as opposed to "A" rounds that offer the possibility of a higher return



- This year's survey found that an overwhelming majority of respondents (80 percent) feel that investors prefer quick / safe investments and smaller returns, as opposed to risky bets on companies that could generate a significant return. We believe this finding is indicative of a fundamental shift in the venture capital paradigm as investors are less willing to make risky investments and are instead focused on smaller, more predictable returns.

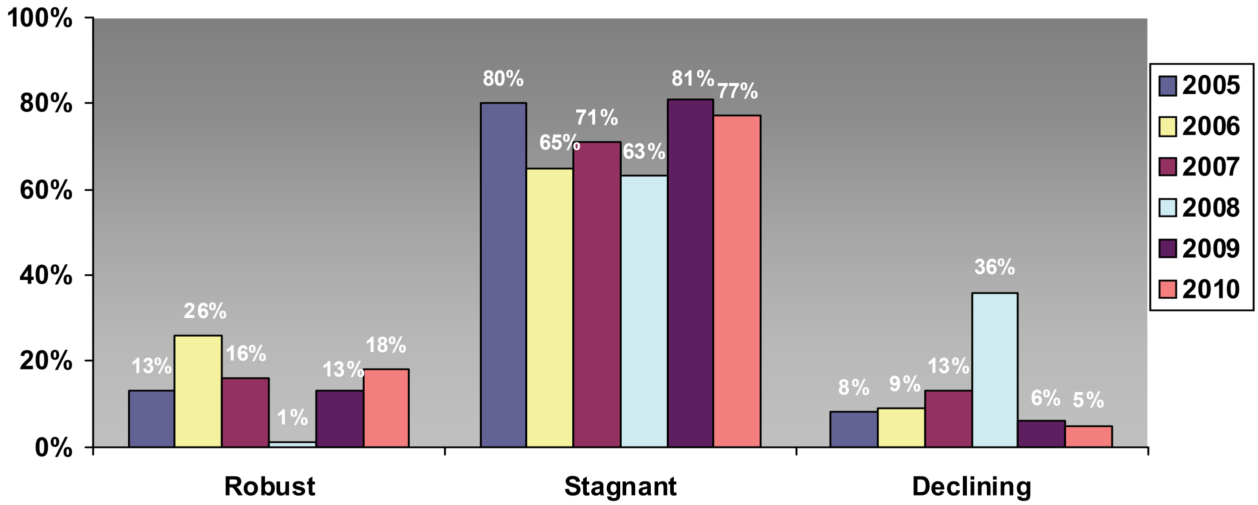
- A majority of respondents (62 percent) also agreed that emerging companies are experiencing greater difficulty closing "B" round funds as opposed to "A" rounds. We believe that as investors focus on quick in-and-out companies and safer returns, many are demonstrating a preference for "A" round investments that require less capital and carry the potential for large returns, as well as late round investments (i.e. "C" or "D" rounds) that are safer as they require less capital and generate predictable, smaller returns. In today's marketplace, investors are less likely to complete a "B" round investment as it generally requires more capital with the potential for only moderate returns.
- The 38 percent of respondents who disagreed with this statement indicated in verbatim responses that "A" rounds are more difficult to secure as investors are: "looking for an established revenue stream," "protecting their A round money," "[expressing] little appetite for innovative ideas that need to have proof of concept established," etc.

Which industries do you believe present the best opportunity for success for emerging companies over the next two years?

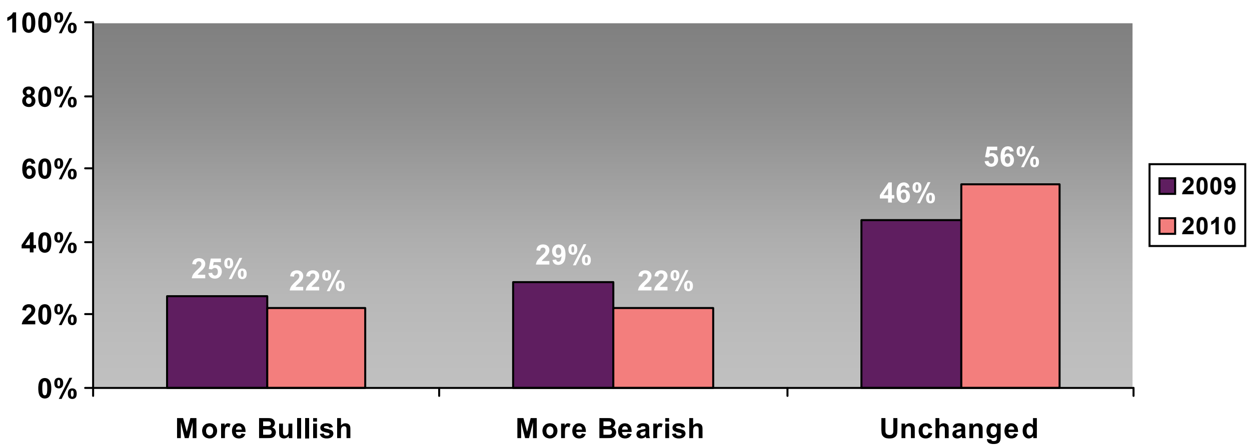


- Respondents expressed optimism for several emerging sectors for start-up companies and predicted opportunities for success over the next two years in clean technology (64 percent); health information services (60 percent); mobile, wireless and telecommunications (45 percent); and cloud computing and SaaS solutions (42 percent).

What is your view of the IPO market over the next two years?



Since the start of 2010, has your view of the IPO market become:



- Although respondents continue to predict a stagnant IPO market (77 percent), we've seen a steady increase in predictions for a robust IPO market over the next two years (1 percent in 2008 to 18 percent in 2010).
- According to Hoover's IPO Scorecard, 30 U.S. companies went public in the third quarter of 2010. This represents a dramatic increase in

comparison to companies that completed an IPO in Q3 2009 (17) and Q3 2008 (5). This data, combined with the increase in respondents predicting a robust IPO market, is a sign of optimism.

METHODOLOGY

In September and October of 2010, Foley & Lardner LLP distributed a survey to a group of founders, executives, advisors, outside consultants, investors, and potential investors in the emerging technology industry. The survey was completed by 198 respondents.

The demographic make-up of respondents includes 34 percent outside consultants/advisors, 60 percent emerging company executives, and 6 percent investors.

The survey coincides with Foley's 2010 Emerging Technologies Conference held in Boston on October 28, 2010 and San Diego on November 2, 2010. These events are attended by many of the respondents completing the survey.

Due to rounding, all percentages used in all questions may not add up to 100 percent.