

THE BUSINESS ENVIRONMENT FACING EMERGING COMPANIES TODAY



A REPORT PRESENTED BY:

FOLEY & LARDNER LLP

OCTOBER 15, 2009



EXECUTIVE SUMMARY

While the business environment for emerging companies remains challenging, there are a number of indicators that reflect optimism among both emerging company executives and investors.

Emerging company executives are cautiously optimistic about available exit strategies but continue to anticipate a lengthy timeframe for an exit.

- After seeing the largest percentage of respondents in survey history who have “no intention to sell” in 2008 (17%), executives are once again exploring opportunities for an exit.
 - Only 12% of respondents now indicate having no intention to sell, and the number of respondents who don’t know their exit strategy has steadily decreased from 2007 (18%) to 2009 (9%).
- Since 2005, the number of emerging company executives citing a merger or sale as their likely exit strategy has decreased consistently. This year’s survey saw the first uptick in executives planning a merger or sale (61%), representing an 8% increase from 2008 and a 5% increase from 2007.
- Although it represents a decrease from the 2008 survey (81%), 72% of emerging company executives are still at least three or more years away from a planned exit.
- Our 2009 survey also saw an increase in the number of respondents accelerating the timing of a merger or acquisition (11% in 2008 to 21% in 2009) and a decrease in those postponing a merger or acquisition (15% in 2008 to 7% in 2009).
 - We attribute this data to a cash flow issue as companies in distressed situations look to a merger or acquisition as they lack the capital to stay afloat.
- Of the executives who indicated planning an exit within the next two years, 56% have accelerated the timing of a planned merger or acquisition. We believe this higher percentage compared to the average respondent is further evidence that executives are increasingly looking to the M&A market as a survival strategy in the current economy.

Emerging company executives, advisors and investors do not yet view the IPO market as a viable exit strategy.

- Similar to previous years, virtually no emerging company executives surveyed (3%) plan to test the IPO market. Further, respondents expect the IPO market to continue to lag, with 81% predicting a stagnant IPO market over the next two years.



- However a good portion of respondents expressed optimism regarding the IPO market.
 - 13% of respondents anticipated a robust IPO market over the next two years, in a significant increase over the 1% of respondents who felt this way during our 2008 survey. Similarly, the number of respondents predicting a declining IPO market decreased from 36% in 2008 to 6% in 2009. This is similar to levels seen during our 2005 survey, at which time the economy was fairly healthy.
 - Additionally, 25% of respondents describe themselves as more bullish on the IPO market since the beginning of this year.

The influence of strategic buyers remains strong in the current economic environment as opportunities for exit remain limited.

- Founders and executives are overwhelmingly tailoring their growth to fit the expectations of strategic buyers as 71% indicated agreement with this statement.
- 55% of respondents agreed or strongly agreed that strategic buyers are more active than at any point over the past five years and the vast majority (77%) agreed that the business plans of emerging companies are influenced by the needs of strategic buyers.

Emerging company executives continue to seek “survival” capital as opposed to “growth” capital as the business environment remains challenging.

- Consistent with data from 2008, companies responding to our survey have sought or obtained capital within the past year (70%) and are planning to do it again within the next year (64%).
- The increase in emerging company executives who recently sought or obtained a capital infusion from 2008 (61%) to 2009 (70%) was surprising as we’d expect respondents wouldn’t go to the market due to current economic conditions. We attribute this finding to companies needing capital for **survival** as opposed to **growth** as their businesses continue to struggle.
- Of the executives who indicated having recently sought or obtained capital, only 3% were planning an exit in the next year and 72% were three or more years away from an exit. This leads us to believe that these executives are seeking “survival capital” as a necessity to survive this cycle and exit when the economy recovers.

The investor community has reached a “survival of the fittest” state – investors who have experienced success are actively raising new funds while others are choosing to walk away.

- Similar to previous years, investors are raising and continue to raise additional capital. 37% have raised capital within the past year and 38% plan to raise their next fund within 12 months.



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- On a less optimistic note, the number of investors indicating they will not raise a new fund has increased dramatically from 2006 (5%) to 2009 (44%). This could indicate that many investors have achieved significant returns in the past and are not willing to risk further investment in the current market.
 - We believe that the 50% of investors indicating that they'll raise funds within the next two years, combined with the 44% who do not plan to raise a new fund, is indicative of a fundamental shift in the venture capital paradigm. Due to dismal returns, we're seeing a fallout in the number of VCs who will survive. The top VC funds are continuing to aggressively raise money, whereas the rest are choosing to walk away.

Emerging company executives, advisors and investors are seeing a silver lining with regard to emerging company valuations and access to capital.

- After witnessing the lowest percentage in survey history of respondents who expect emerging company valuations to grow in 2008 (38%), respondents are seeing the silver lining in emerging company valuations.
- 72% of respondents now expect emerging company valuations to grow over the next two years and only 12% expect a decline (compared to 41% in 2008).
- Respondents were extremely pessimistic in regards to access to capital in 2008, with only 30% expecting access to capital to grow and 45% expecting a decline. Our 2009 survey saw a significant turnaround with 73% indicating access to capital will grow over the next two years and only 11% anticipating a decline.
- This mirrors optimism expressed in the outlook for emerging company valuations and is similar to the more hopeful findings of our 2005 and 2006 surveys.



VERBATIMS

Have you found that a lack of available capital allows you to do more with less and drive innovation?

(Note that this question was only addressed to those respondents who identified themselves as a “founder or executive of an emerging company”)

- *Not allows, but forces doing more with less. This requires innovation in research design and business practices. It also stifles innovation as some good ideas don't get funded internally in companies or in the industry in new companies.*
- *Absolutely! I believe one of the best tools to enhance innovation is to constrain resources. Unfortunately, many leaders and companies typically increase resources when they encounter a problem or obstacle. In my experience, a far better solution to overcoming problems and obstacles is keep resources tight and force the organization reevaluate possible solutions to the problem or obstacle. Tight resources greatly increase the probability the organization will "think outside the box" and develop innovative solutions.*
- *No. It allows those competitors who happen to have capital an opportunity to fill in the entrepreneurial niches thereby squeezing out emerging companies and investors.*
- *Yes. We have become far more diligent about expense control and cash management. We have scrapped those initiatives that weren't working and emphasized those that are working.*
- *It has been both good and bad. The bad being a lack of resources to execute on some key aspect of the business which has made our current fund raising process more challenging. The good being the need for us to be more innovative with our customer acquisition strategy. We have grown the business 3x since a 50% reduction in expenses in October all without spending marketing dollars. Had we been flush with cash we would have never been so aggressive with a zero cost acquisition strategy.*
- *Yes. Gives us an opportunity to correct long term problems.*
- *It forces creativity and cost effective partnerships. Government funding programs have become a major focus for us.*
- *Our company is operating in a virtual fashion as we await VC financing.*
- *No, a lack of capital has simply made it impossible to hit the growth numbers we had planned. Capital is too expensive and not worth the effort.*



VERBATIMS (CONTINUED)

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

- *Angel investors will become more critical to early stage companies that cannot raise VC money until the companies prove a concept or develop a track record.*
- *Strategic investors are more active due to the lack of VC investing which allows them access to emerging technologies at lower valuations.*
- *Very weak. The reason for going to these sources is that there is almost no VC money available for an early stage company.*
- *Angel funding is harder to get and University endowments are constrained. Strategic non PE buyers are the most active because of little competition and lower valuations due to recession and lack of capital.*
- *They are the ones taking the risks now. They are the ones interested in helping to develop the company. VCs need projects of lower risk, that are going to be big quickly, and there are not many of those.*
- *These sources of capital will allow flexible emerging companies to weather the current US crisis and succeed in the future markets.*
- *They are the only place to go for really early stage funding since angels are banding together and becoming much more like VCs. Finding them is the hard part.*
- *There appear to be more investors that are willing to put up smaller amounts (\$25K - \$50K) in risky early stage concepts. What is missing is a formal environment that cobbles these investors together that would enable a venue for early stage companies to raise the first \$500K to \$1M. Angel funds and investment clubs are not filling this need as they run closer to the traditional VC model.*



VERBATIMS (CONTINUED)

How do you think the government's ongoing response to the lingering recession is going to impact your business going forward?

- *Exits will be significantly delayed which will make it harder to raise another fund.*
- *It is going to cause inflation on a frightening scale.*
- *Government response may appear to be massive but few have seen any stimulus money dollars and will not see any until 2010. For example, I submitted 4 ARPA-E concept papers at the DoE, each valued at \$5M ... all rejected. DoE has enough money to fund 30 of these, they received 3,500 applications!*
- *The government's stimulus actions will stabilize the economy and set the stage to return to normal economic activity which will in turn have positive impact on M&A and VC investing.*
- *Reducing innovation and increasing time to market.*
- *The government's response to the lingering recession will definitely have an impact, both good and bad. The economic stimulus will help stabilize equity markets and facilitate growth, which will be positive near term. However, increased government regulations (which are always costly) and longer term inflation due to government debt will be negative.*
- *It has shortened the length and reduced the severity of the recession improving immediate business prospects. The medium term impact of government debt levels are likely to be negative with lower growth rates though compared with the alternative.*
- *Regulatory changes which currently remain uncertain will continue to cause a weak market. Delay of established written policies and procedures from Washington will cause delay in recovery. Government initiatives intended to restore efficient functioning of collateralized debt markets have the potential of impacting positive returns if deployed correctly*



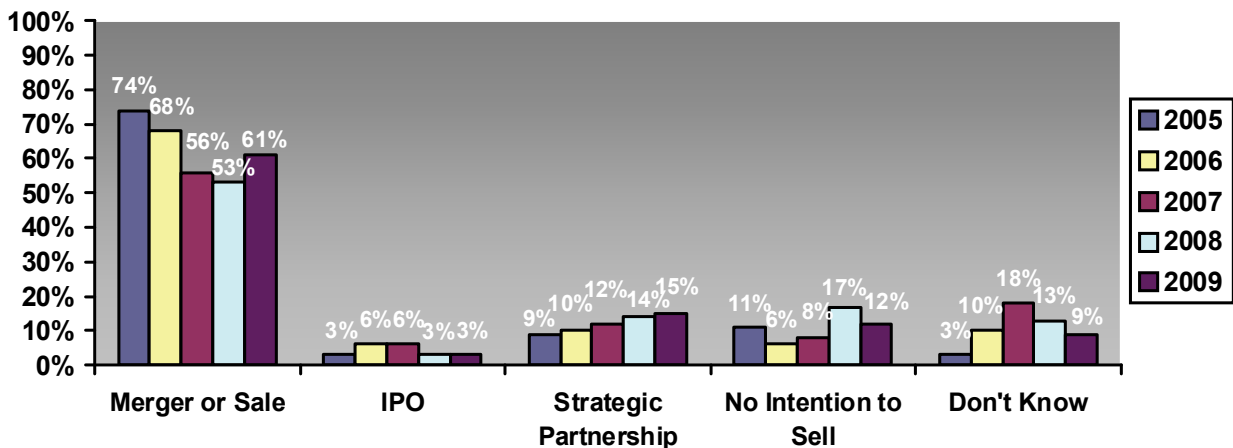
ANALYSIS OF EMERGING COMPANY SURVEY

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?

(Note that this question was only addressed to those respondents who identified themselves as a “founder or executive of an emerging company”)

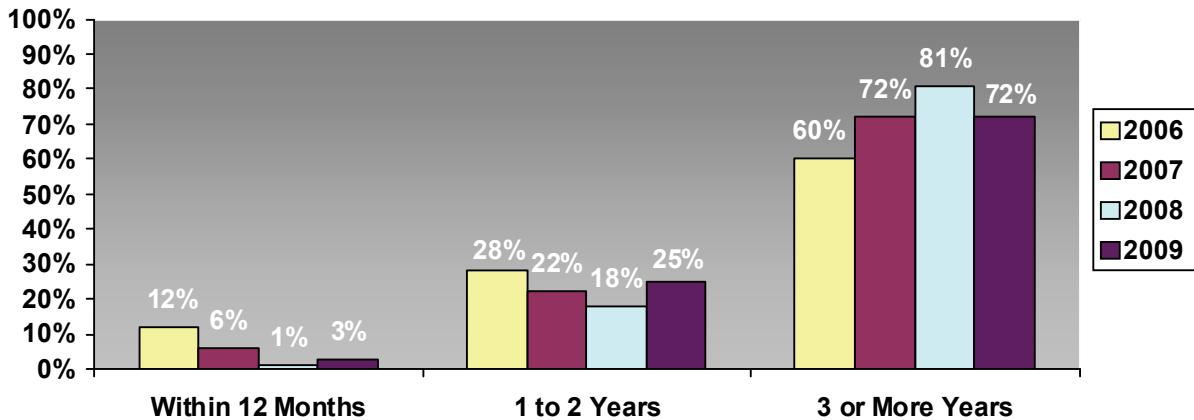


- After seeing the largest percentage of respondents in survey history who have “no intention to sell” in 2008 (17%), executives are once again exploring opportunities for an exit.
- Only 12% of respondents now indicate having no intention to sell, and the number of respondents who don’t know their exit strategy has steadily decreased from 2007 (18%) to 2009 (9%).
- Since 2005, the number of emerging company executives citing a merger or sale as their likely exit strategy has decreased consistently. This year’s survey saw the first uptick in executives planning a merger or sale (61%), representing an 8% increase from 2008 and a 5% increase from 2007.
- Similar to previous years, virtually no respondents (3%) plan to test the IPO market. However, if we were to survey respondents in Q4, we might see more optimism in this category given the five IPOs announced in late September.



What is your likely timeframe for an exit?

(Note that this question was only addressed to those respondents who identified themselves as a “founder or executive of an emerging company”)

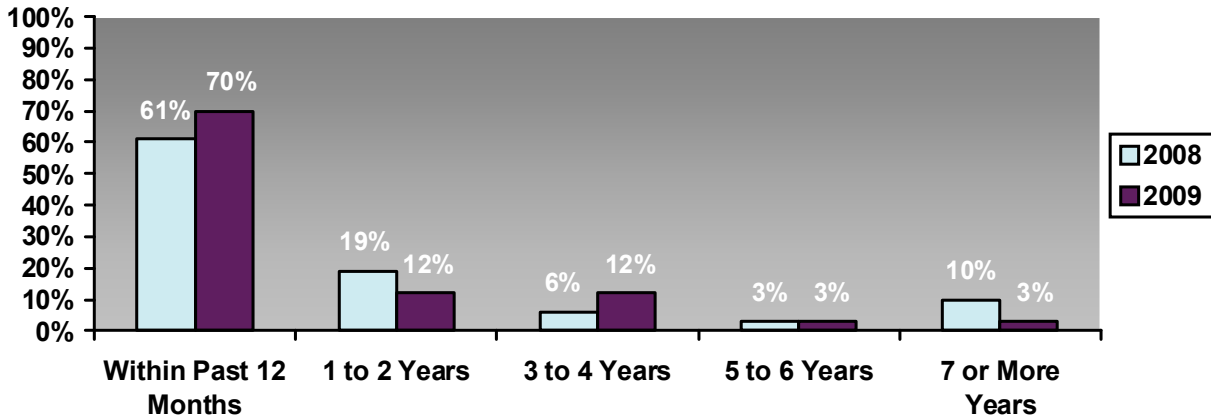


- Similar to results seen in our 2008 survey, most executives anticipate a lengthy timeframe for an exit.
- Although it represents a decrease from the 2008 survey (81%), 72% of emerging company executives are still at least three or more years away from a planned exit.
- However it is significant to note that data for this question is moving increasingly toward levels seen in the first year of this survey (2006), which was a fairly robust economy. 25% of respondents indicated a one to two year exit timeframe, which mirrors the 28% that anticipated such a timeframe in 2006.

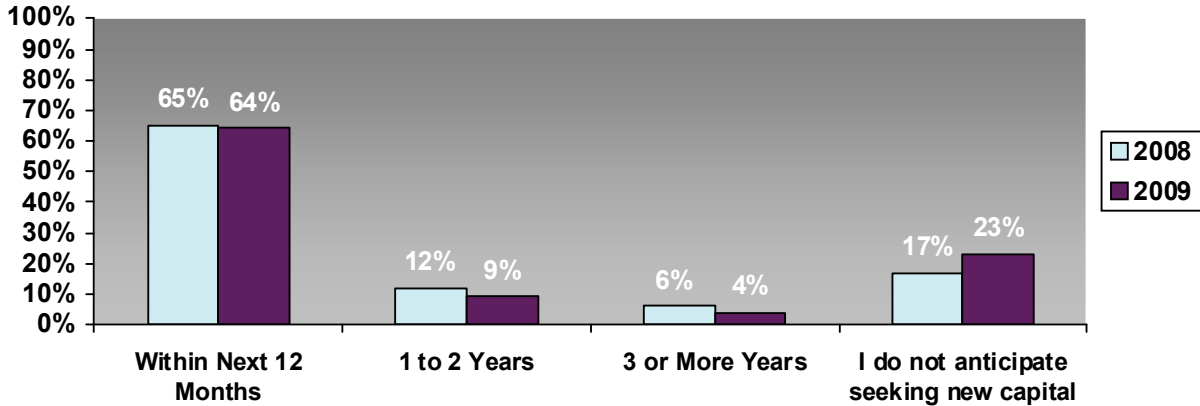


When did you last seek or obtain a capital infusion for your business?

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



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



- Consistent with data from 2008, companies responding to our survey have sought or obtained capital within the past year (70%) and are planning to do it again within the next year (64%).
- The increase in emerging company executives who recently sought or obtained a capital infusion from 2008 (61%) to 2009 (70%) was surprising as we'd expect respondents wouldn't go to the market due to current economic conditions. We attribute this finding to



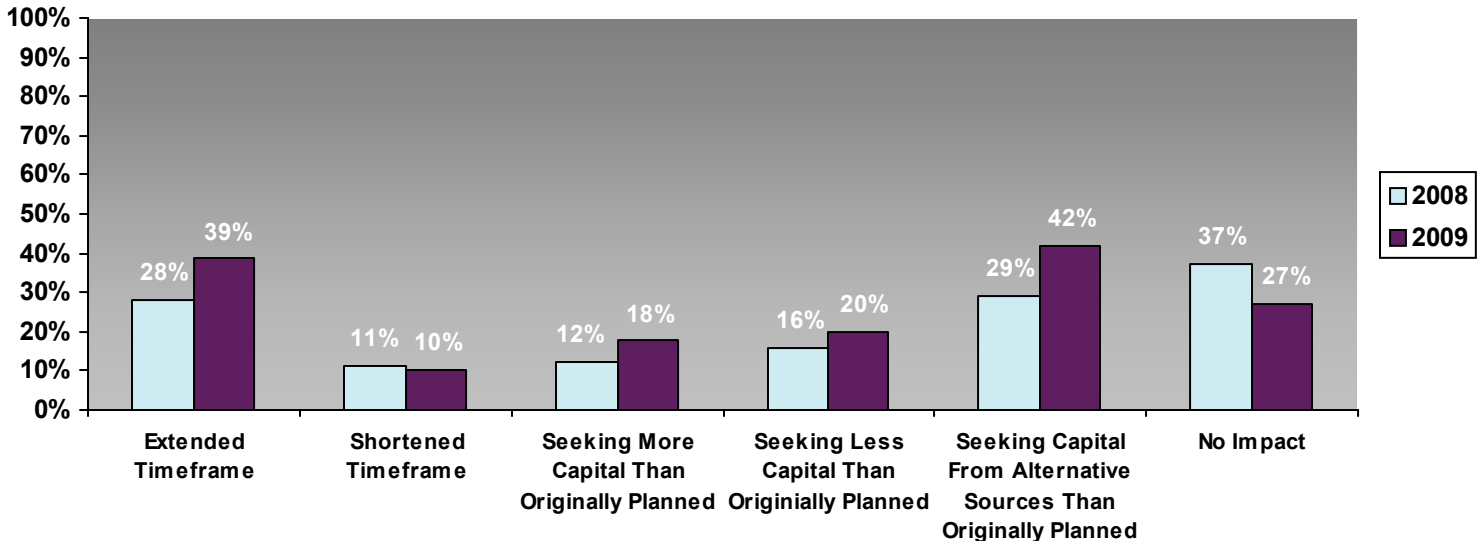
companies needing capital for **survival** as opposed to **growth** as their businesses continue to struggle.

- Of the executives who indicated having recently sought or obtained capital, only 3% were planning an exit in the next year and 72% were three or more years away from an exit. This leads us to believe that these executives are seeking “survival capital” as a necessity to survive this cycle and exit when the economy recovers.



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

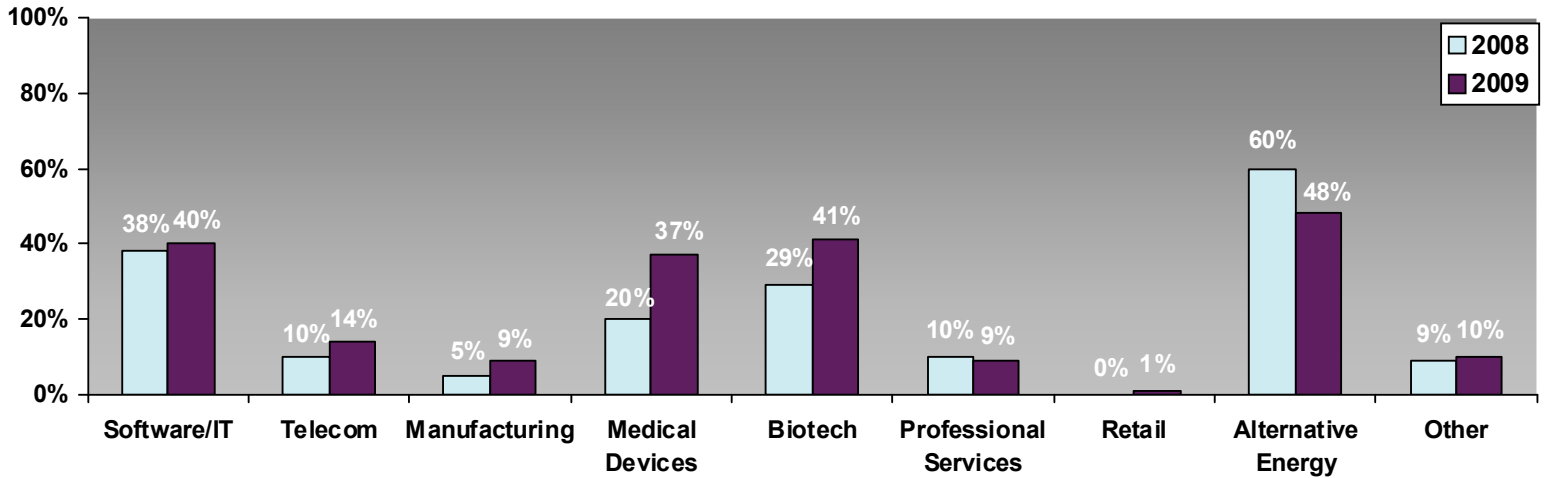
(Note that this question was only addressed to those respondents who identified themselves as a “founder or executive of an emerging company”)



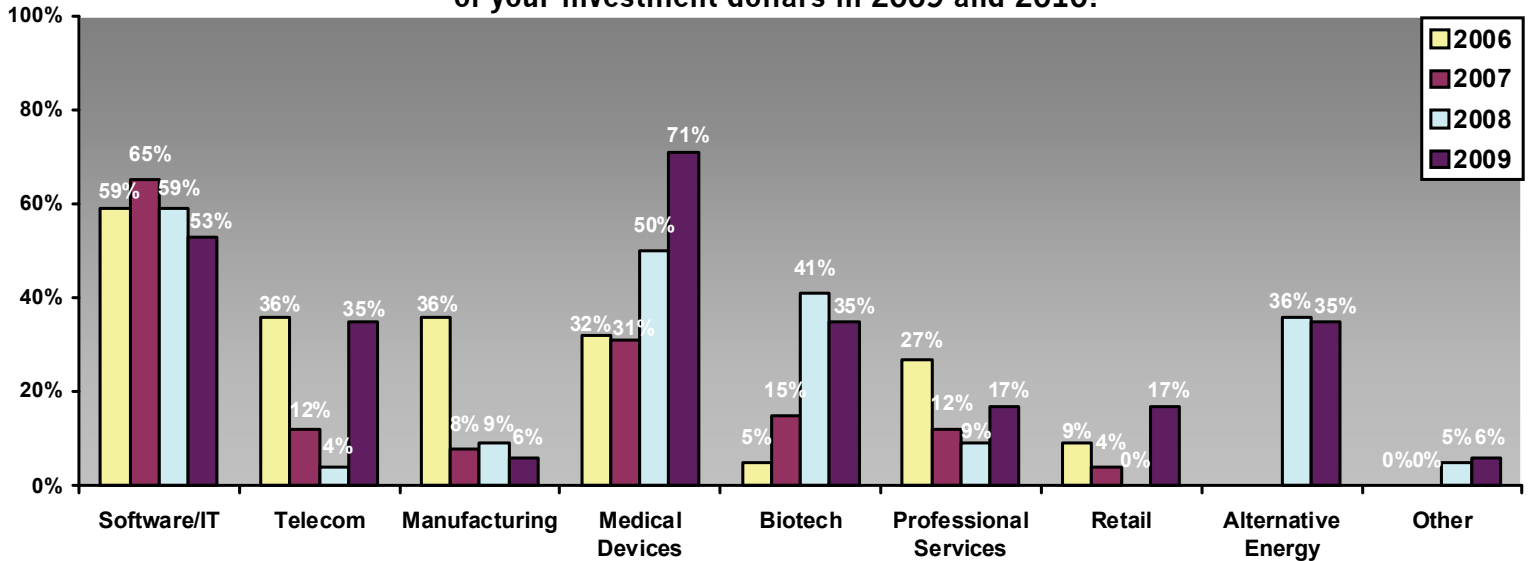
- Our 2009 survey saw an increase in the impact of economic conditions on emerging companies' plans to raise capital.
- The number of emerging company executives extending their timeframe in an effort to raise capital increased from 2008 (28%) to 2009 (39%), as did those seeking capital from alternative sources (29% in 2008 to 42% in 2009).
- Of the executives who indicated having sought or obtained capital in the past year, 46% have extended their exit timeframe, 24% are seeking more capital than originally planned and 50% are seeking capital from alternate sources. We believe these higher percentages compared to the average respondent demonstrates that executives are having trouble raising capital and the majority of those who went to the market for capital were desperate to keep their companies afloat during the downturn.
- The percentage of executives responding to our survey who felt that the economy has had no impact on plans to raise capital saw a decrease from 2008 (37%) to 2009 (27%). This could signify that more executives are now feeling the impact of the economic downturn, compared to this time last year.



Emerging Company Executives: Which industries do you believe present the *best opportunity for success* for emerging companies over the next two years?



Investors: In which industries do you expect to focus most of your investment dollars in 2009 and 2010?



- While our 2008 survey found that executives and investors are not in agreement on the industries best poised for success, data from 2009 was a bit more aligned.



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- Investors responding to our survey saw the greatest opportunity in the areas of medical devices (71%) and software/IT (53%). Although to a lesser degree, executives and founders were also bullish in these areas, with 37% choosing medical device and 40% choosing software/IT.
 - Software/IT and medical devices have an investment cycle advantage as companies can be built easily and cheaply. In contrast, biotech companies require more capital and have a longer timeframe for an exit
 - Enthusiasm for the alternative energy sector moved closer to alignment in 2009 with 48% of executives and 35% of investors choosing this sector as poised for success. Surprisingly, interest among emerging company executives dropped from 2008 to 2009, despite the government's various programs to finance clean energy projects.

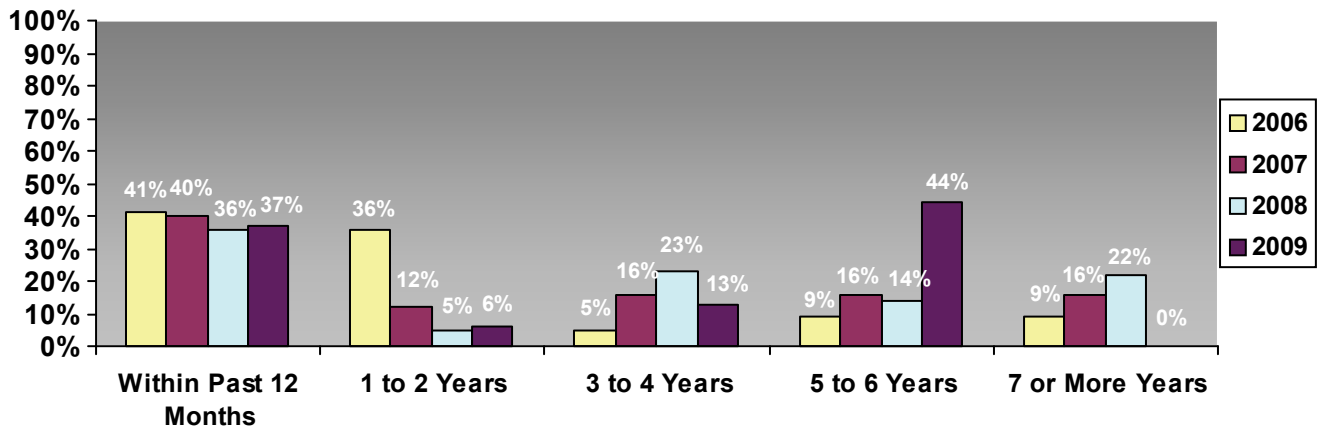


PERSPECTIVE FROM INVESTORS IN EMERGING COMPANIES

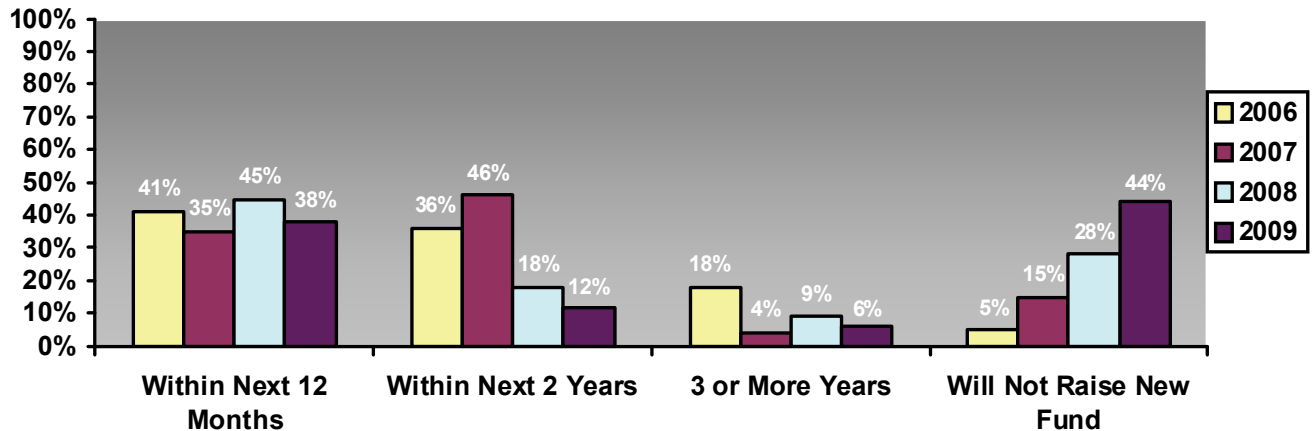
The following questions reflect input received from respondents who actively invest in emerging companies.

When was the last time you raised capital as a new fund?

(Note that these questions were only addressed to those respondents who identified themselves as an “investor”)



When do you expect to raise your next fund?



- Similar to previous years, investors are raising and continue to raise additional capital. 37% have raised capital within the past year and 38% plan to raise their next fund within 12 months.

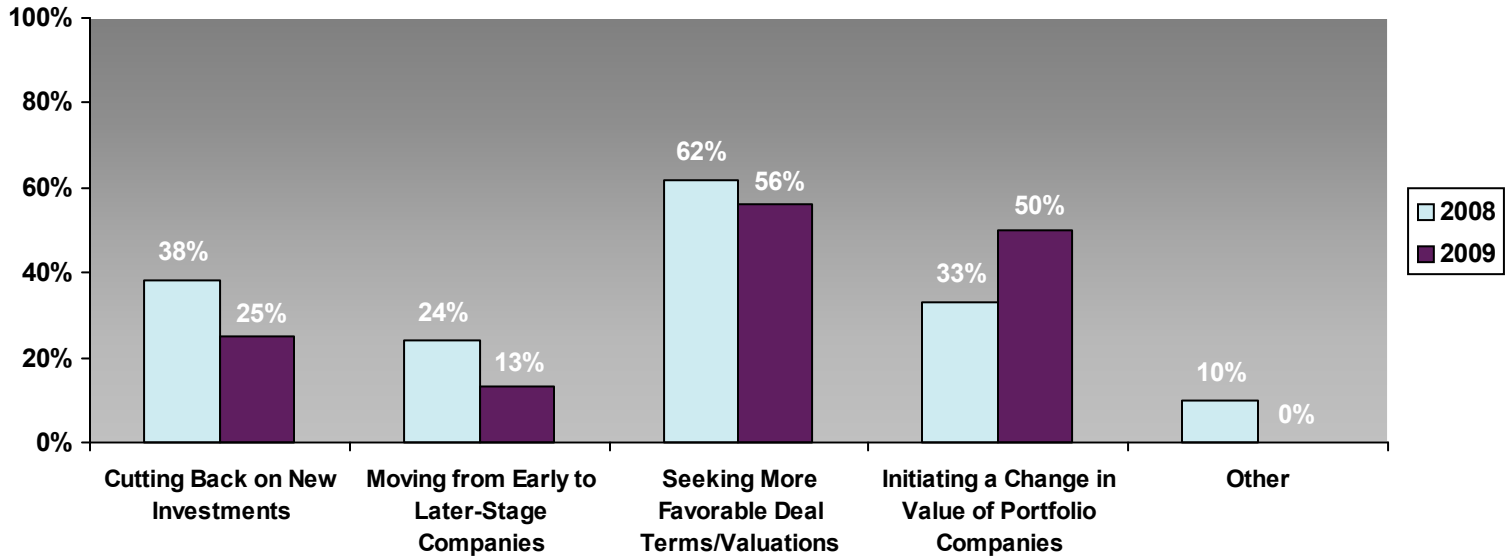


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- On a less optimistic note, the number of investors indicating they will not raise a new fund has increased dramatically from 2006 (5%) to 2009 (44%). This could indicate that many investors have achieved significant returns in the past and are not willing to risk further investment in the current market.
 - We believe that the 50% of investors indicating that they'll raise funds within the next two years, combined with the 44% who do not plan to raise a new fund, is indicative of a fundamental shift in the venture capital paradigm. Due to dismal returns, we're seeing a fallout in the number of VCs who will survive. The top VC funds are continuing to aggressively raise money, whereas the rest are choosing to walk away.



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

(Note that this question was only addressed to those respondents who identified themselves as an “investor.”)

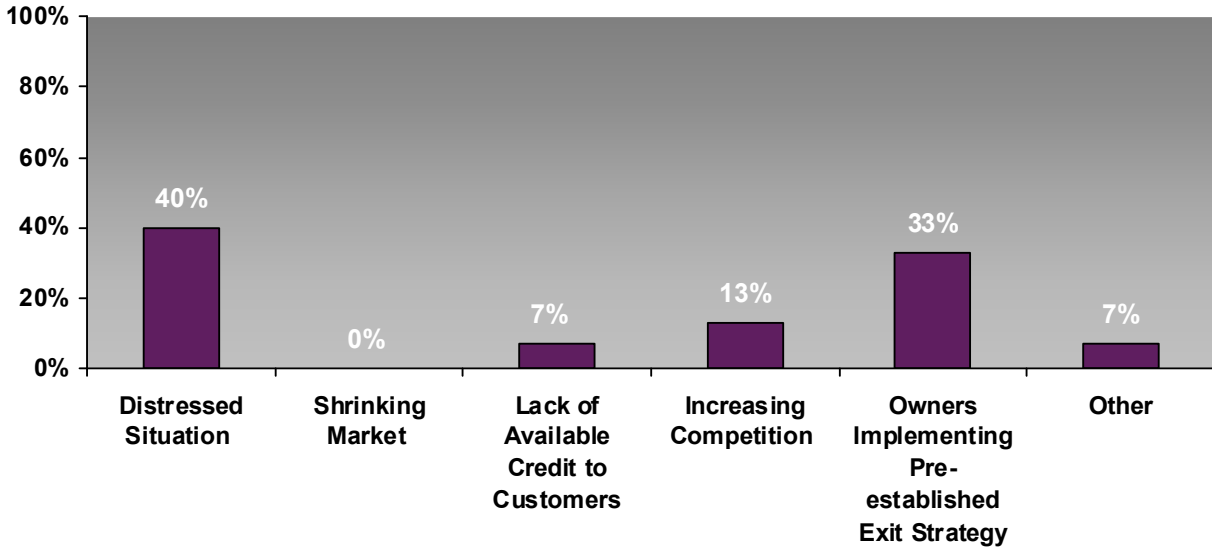


- It is clear that investors are continuing to take the opportunity, whether because it's needed or because it's simply available, to leverage current economic conditions to obtain more favorable deal terms and valuations (56%).
- The number of investors initiating a change in value of portfolio companies increased from 2008 (33%) to 2009 (50%). However, we were surprised to see a decrease in those cutting back on new investments from 2008 (38%) to 2009 (25%).



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

(Note that this question was only addressed to those respondents who identified themselves as an "investor.")



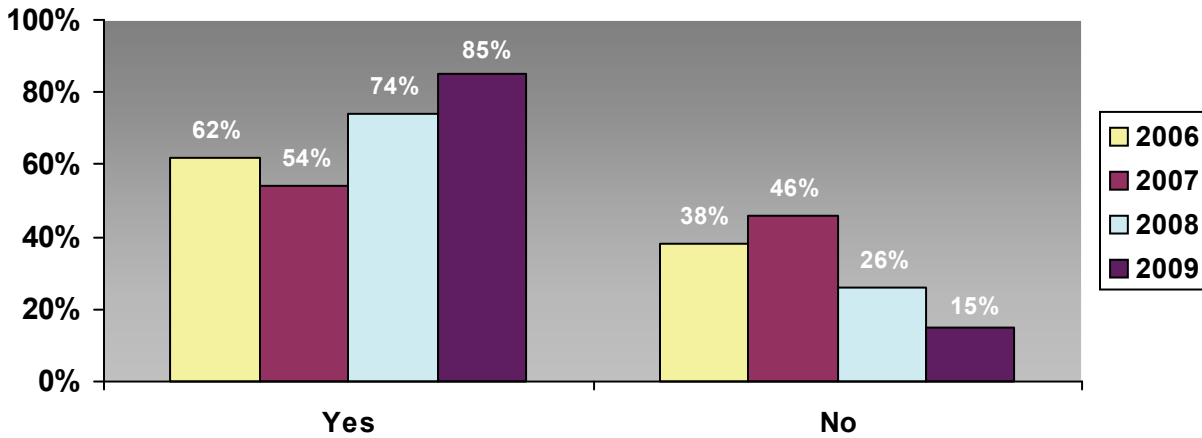
- This year's survey saw a high percentage of investors (40%) indicating a distressed situation as the most frequent motivation behind a company's decisions to sell.
- This data is consistent with the 61% of emerging company executives citing a merger or sale as their likely exit strategy.



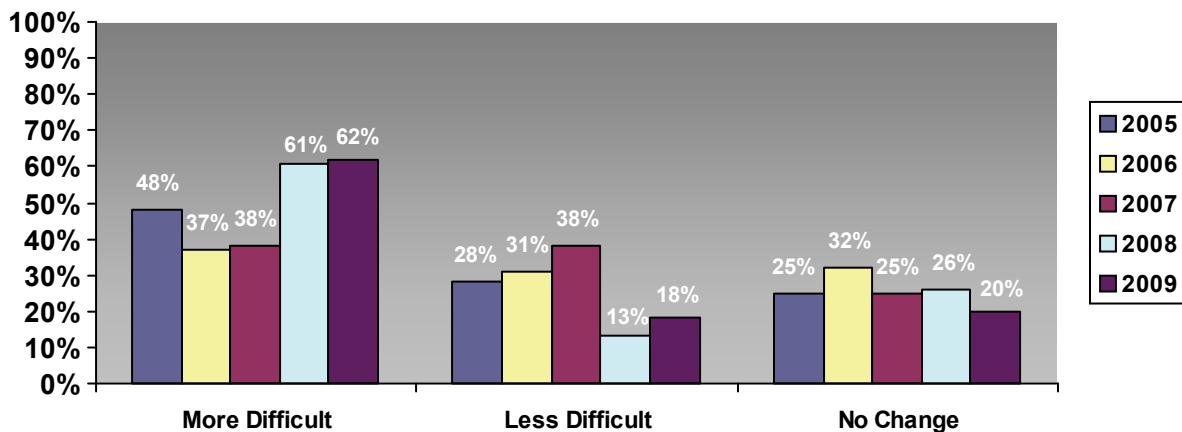
PERSPECTIVE FROM ALL RESPONDENTS

The following questions reflect input received from all 230 respondents. The demographic make-up of respondents includes 40% outside consultants/advisors, 52% emerging company executives and 8% investors.

Do you believe that companies need to survive on less capital than they did 10 years ago?



Do you believe it is more difficult to start a company today versus 10 years ago?



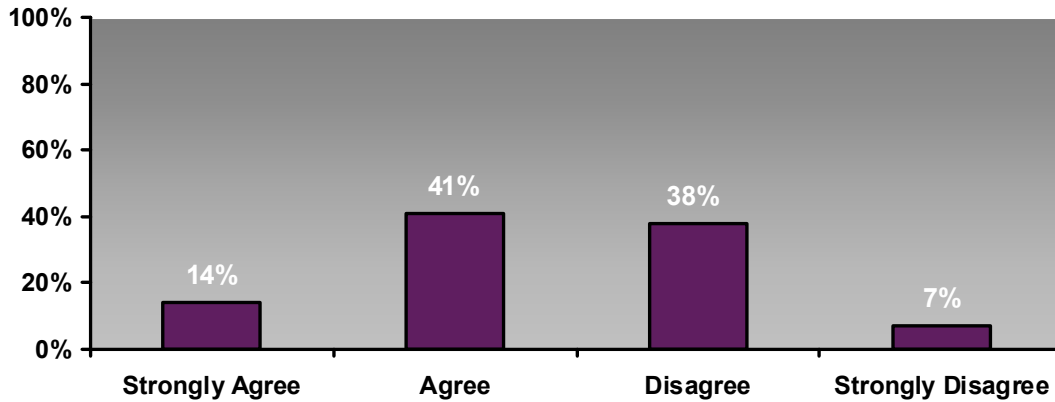
- It is becoming increasingly difficult year-over-year to start and run an emerging company within the current economic environment.



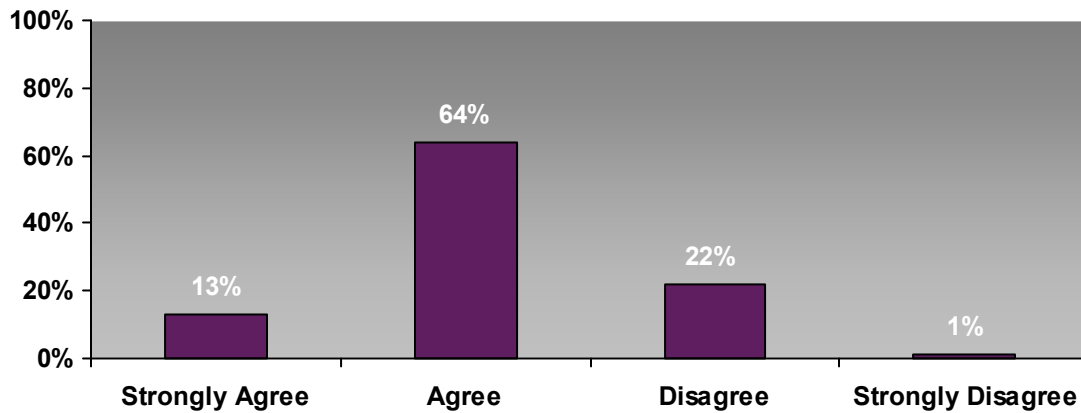
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- 85% of respondents indicated that companies need to survive on less capital than they did 10 years ago, representing a significant increase from our 2007 survey (54%) and the highest percentage in five-year survey history. Furthermore, the majority of respondents (62%) continue to believe that it is more difficult to start a company today compared to 10 years ago.



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 5 years



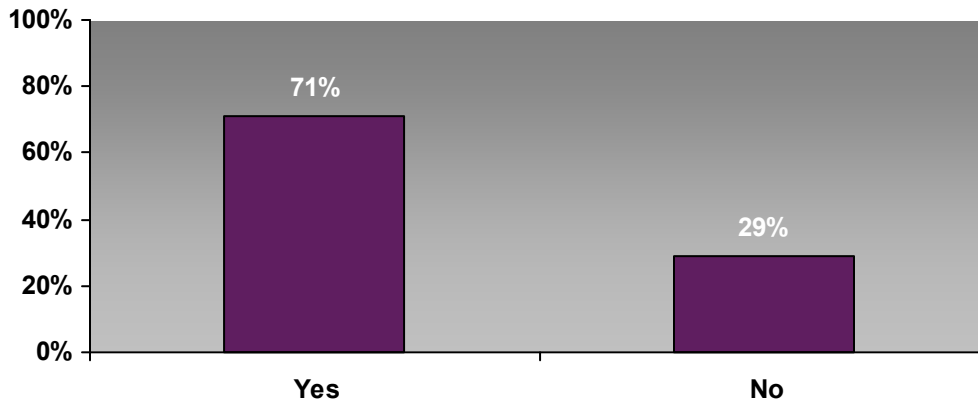
To what extent do you agree with this statement: The business plans of today's emerging companies are influenced by the known needs of strategic buyers





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

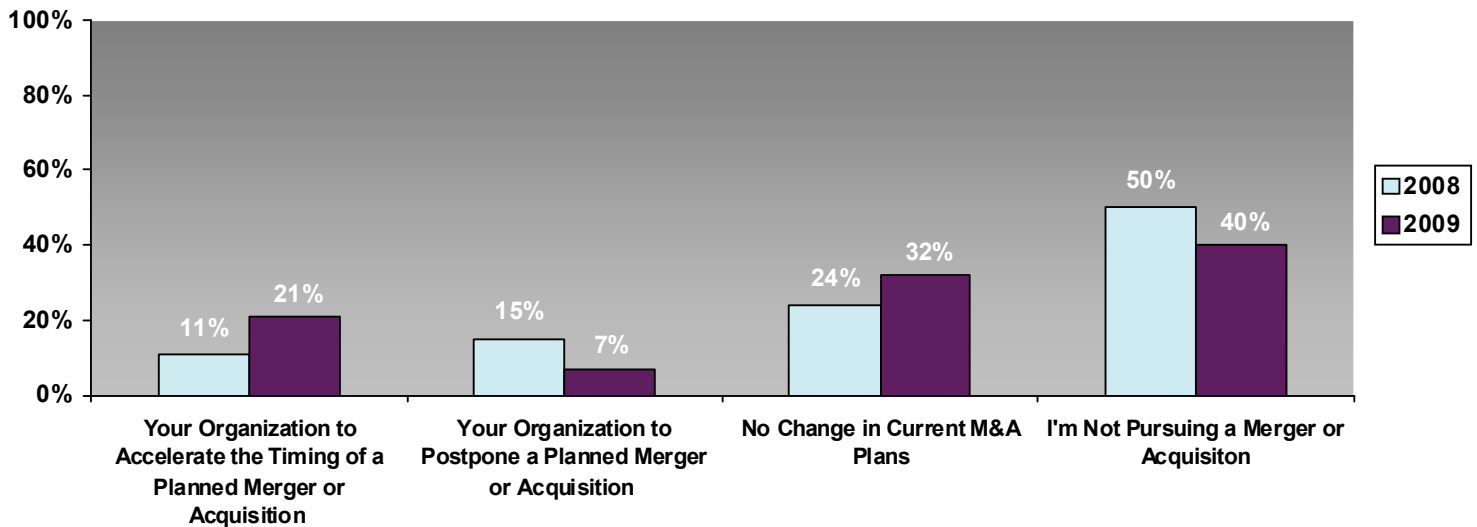
(Note that this question was only addressed to those respondents who identified themselves as a “founder or executive of an emerging company.”)



- Respondents clearly acknowledged the presence and impact of strategic buyers in today’s market. Founders and executives are overwhelmingly tailoring their growth to fit the expectations of strategic buyers as 71% indicated agreement with this statement.
- 55% of respondents agreed or strongly that strategic buyers are more active than at any point over the past five years and the vast majority (77%) agreed that the business plans of emerging companies are influenced by the needs of strategic buyers.
- This finding is consistent with the numerous strategic acquisitions of emerging tech companies in recent months, including:
 - Xerox’s acquisition of Affiliated Computer Services for \$6.4 billion to bolster outsourcing services
 - Dell’s \$3.9 billion acquisition of Perot Systems to gain a better foothold in the IT services market
 - Cisco’s \$3 billion purchase of video communications company, Tandberg, to build its video conferencing portfolio
- The prevalence of strategic buyers is also an interesting commentary on the private equity and IPO marketplace. With 71% of executives planning a strategic exit, the private equity and IPO markets, which have driving exit strategies over the past few years, are likely to be less common. It will be interesting to see how this shifts next year if the IPO market becomes more robust and liquidity expands.



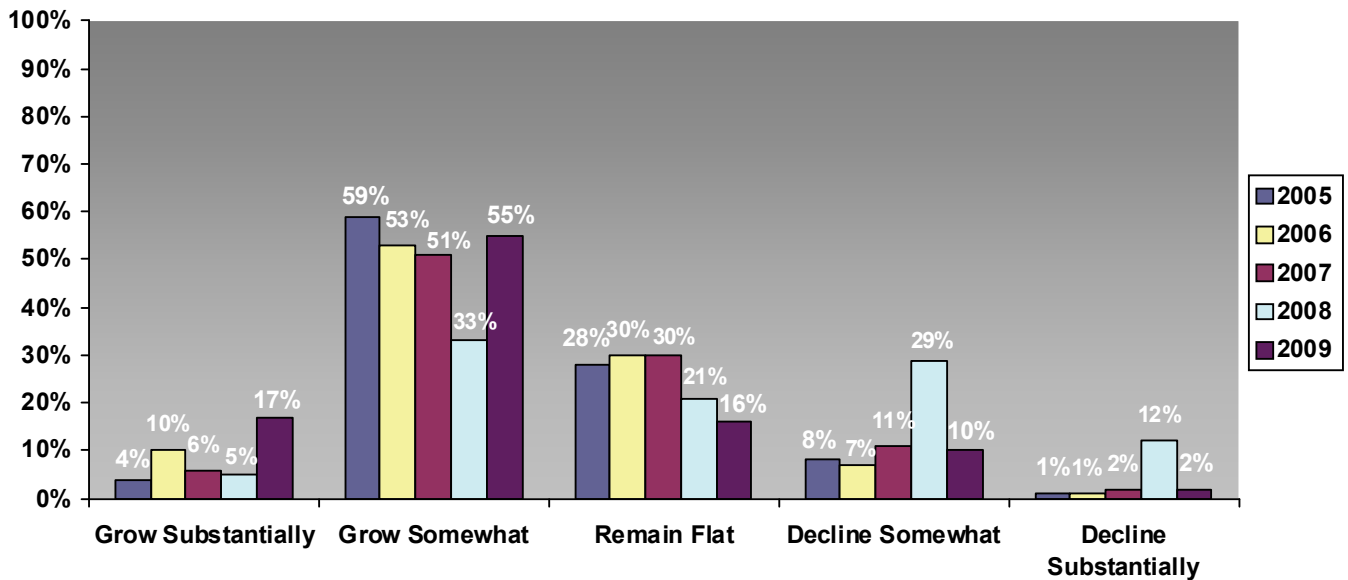
Current market conditions will cause:



- Our 2009 survey saw an increase in the number of respondents accelerating the timing of a merger or acquisition (11% in 2008 to 21% in 2009) and a decrease in those postponing a merger or acquisition (15% in 2008 to 7% in 2009).
- This is consistent with the finding that emerging company executives are increasingly open to a merger or sale as an exit strategy.
- We attribute this data to a cash flow issue as companies in distressed situations look to a merger or acquisition as they lack the capital to stay afloat.
- Of the executives who indicated planning an exit within the next two years, 56% have accelerated the timing of a planned merger or acquisition. We believe this higher percentage compared to the average respondent is further evidence that executives are increasingly looking to the M&A market as a survival strategy in the current economy.



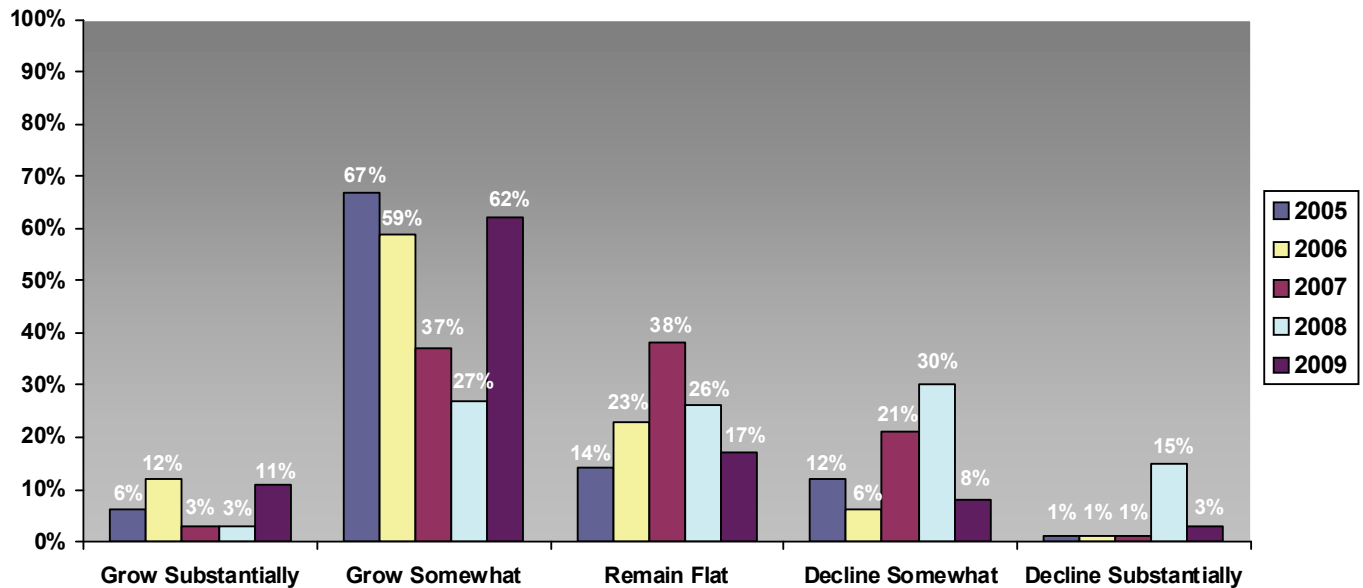
Over the next two years emerging company valuations will:



- After witnessing the lowest percentage in survey history of respondents who expect emerging company valuations to grow in 2008 (38%), respondents are seeing the silver lining in emerging company valuations.
- 72% of respondents now expect emerging company valuations to grow over the next two years and only 12% expect a decline (compared to 41% in 2008).
- We believe this indicates that we've reached the bottom of the market and are starting to see signs of optimism.



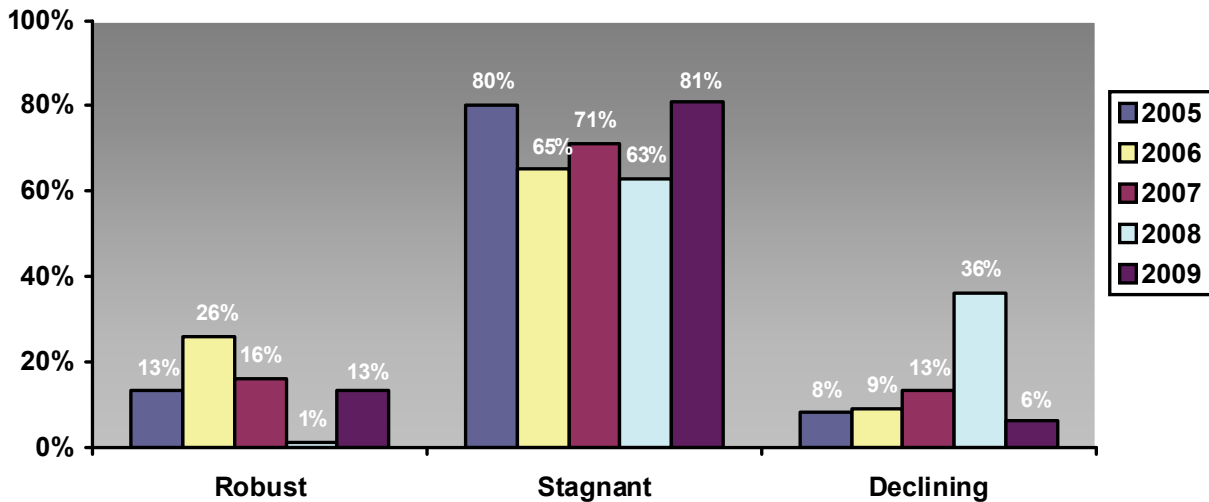
Over the next two years access to capital will:



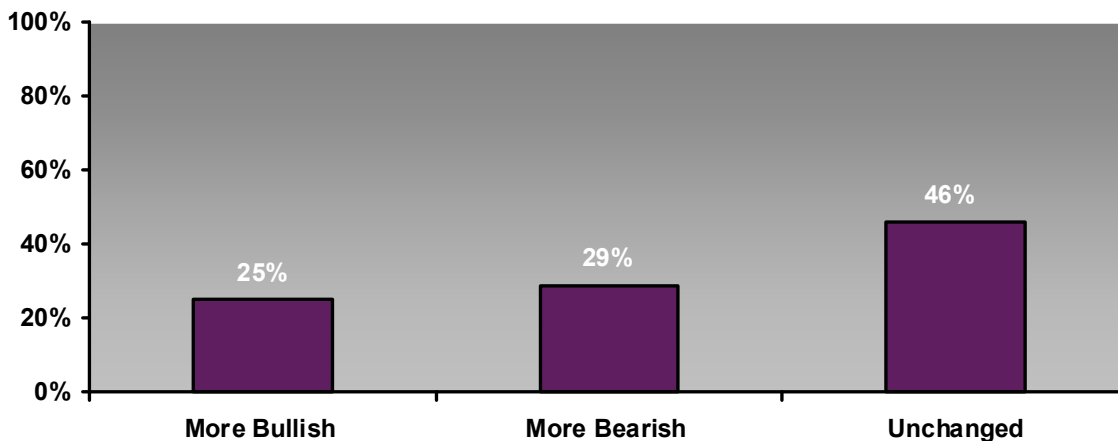
- Respondents indicated a clear belief that access to capital is likely to improve over the next two years.
- Respondents were extremely pessimistic in regards to access to capital in 2008, with only 30% expecting access to capital to grow and 45% expecting a decline. Our 2009 survey saw a significant turnaround with 73% indicating access to capital will grow over the next two years and only 11% anticipating a decline.
- This mirrors optimism expressed in the outlook for emerging company valuations and is similar to the more hopeful findings of our 2005 and 2006 surveys.



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



Since the start of 2009, has your view of the IPO market become:



- Respondents expect the IPO market to continue to lag, with 81% predicting a stagnant IPO market over the next two years. However a good portion of respondents expressed optimism regarding the IPO market.
- 13% of respondents anticipated a robust IPO market over the next two years, in a significant increase over the 1% of respondents who felt this way during our 2008 survey. Similarly, the number of respondents predicting a declining IPO market decreased from

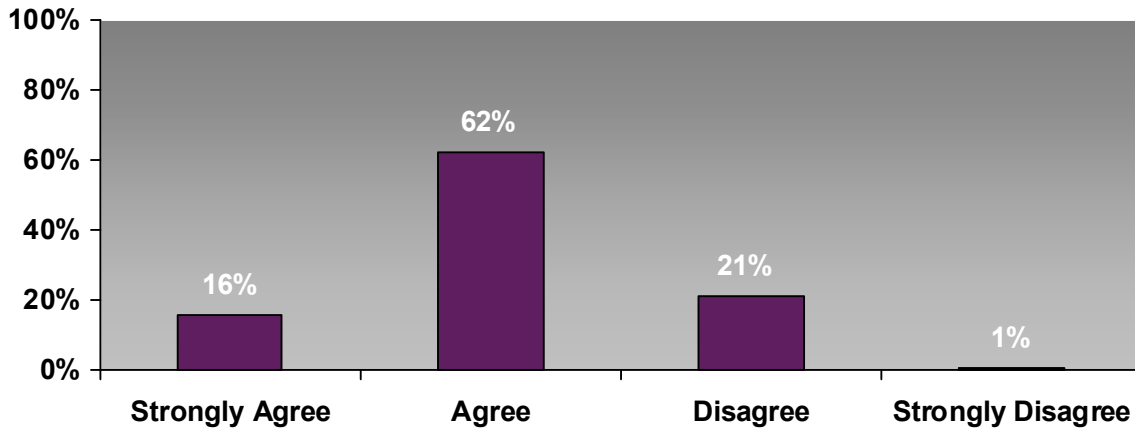


36% in 2008 to 6% in 2009. This is similar to levels seen during our 2005 survey, at which time the economy was fairly healthy.

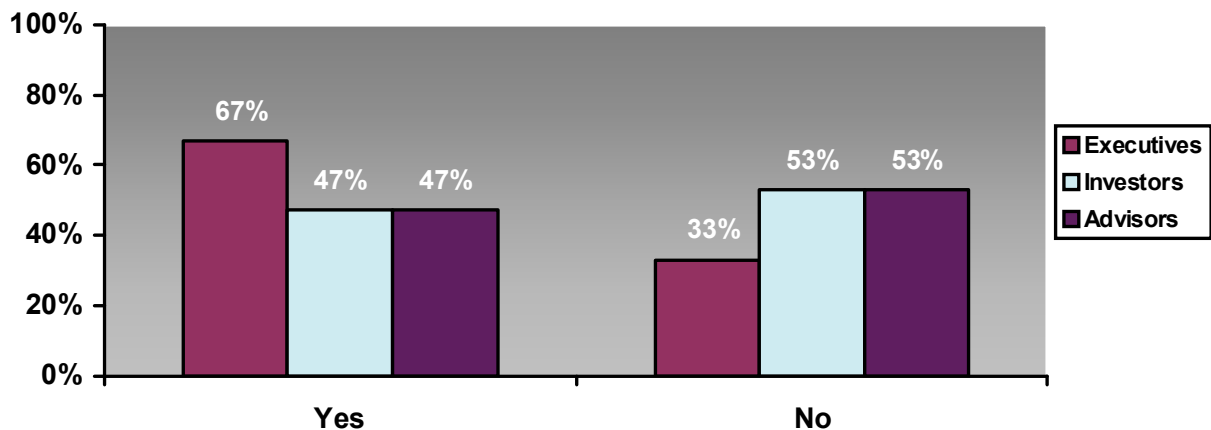
- Additionally, 25% of respondents describe themselves as more bullish on the IPO market since the beginning of this year.
- According to Hoover's IPO Scorecard, 17 U.S. companies went public in the third quarter, which is triple the number of companies that completed an IPO in the third quarter of 2008. This data combined with the increase in respondents predicting a robust IPO market over the next two years is a sign of optimism.



To what extent do you agree with this statement: As capital continues to remain on the sidelines, pent up demand for investment is becoming palpable in today's business environment



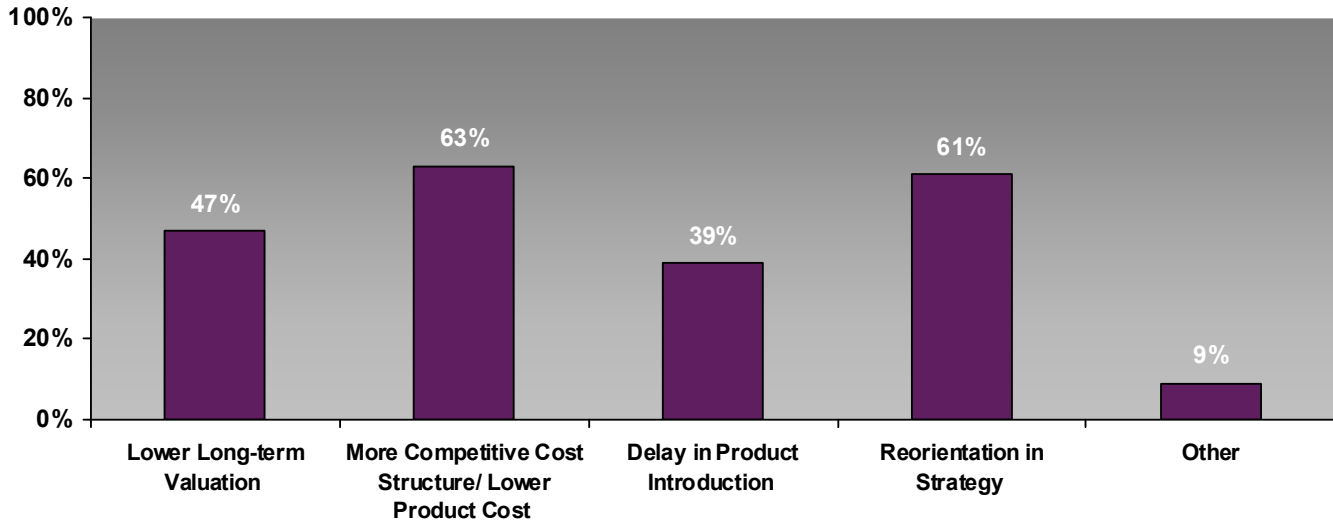
Do you believe the current market for emerging company valuations is artificially low?



- 78% of respondents agreed or strongly agreed that pent up demand for investment is becoming palpable in today's business environment.
- 67% of executives agreed that the current market for emerging company valuations is artificially low, while investors and advisors were split on this question. As economic conditions continue to weigh on emerging companies, executives are clearly feeling the impact on the perceived value of their businesses.



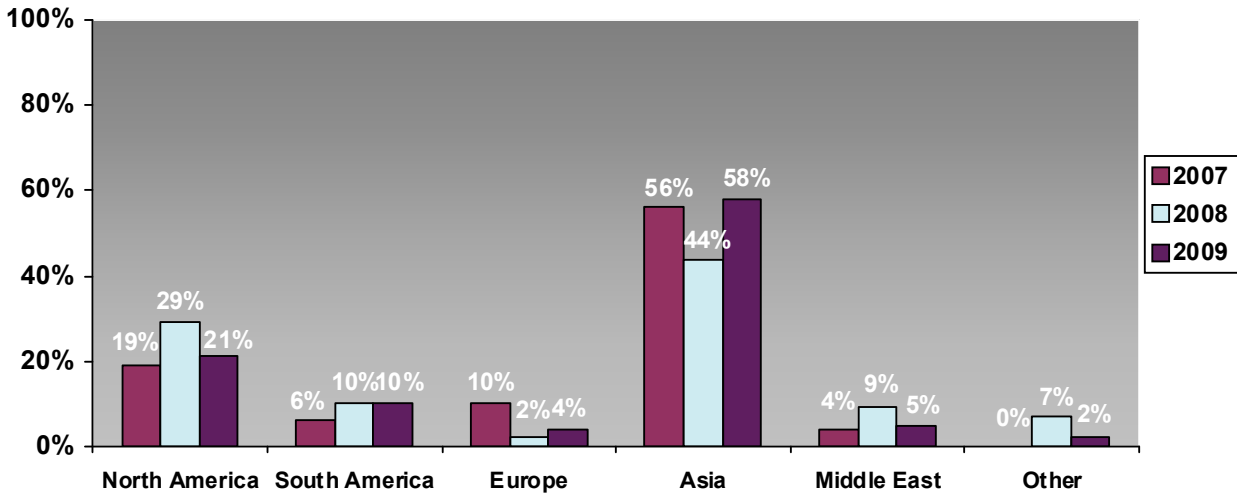
What long-term impacts do you expect the current global recession will have on business?



- This year's survey found that respondents anticipate a several long-term impacts on their business as a result of the current recession, which we believe this indicates a paradigm shift in how businesses will operate moving forward.
- As opposed to expecting to get back to business as usual in 2010, 61% expect a reorientation in strategy moving forward; 63% anticipate a more competitive cost structure or lower product cost; and 39% will likely delay product introduction.



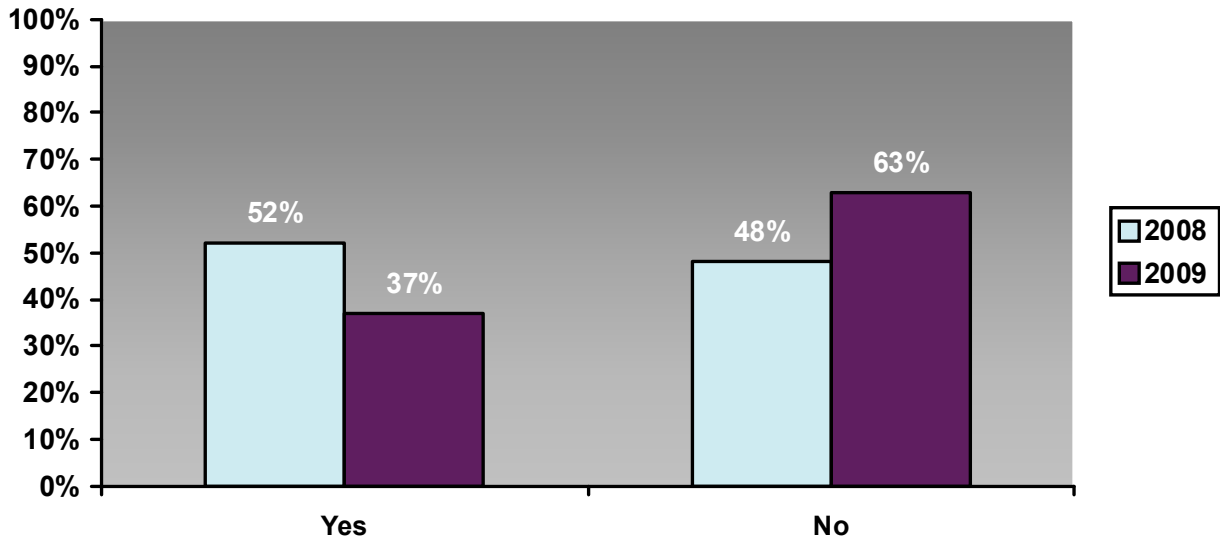
What regions are best poised for economic growth to benefit emerging companies?



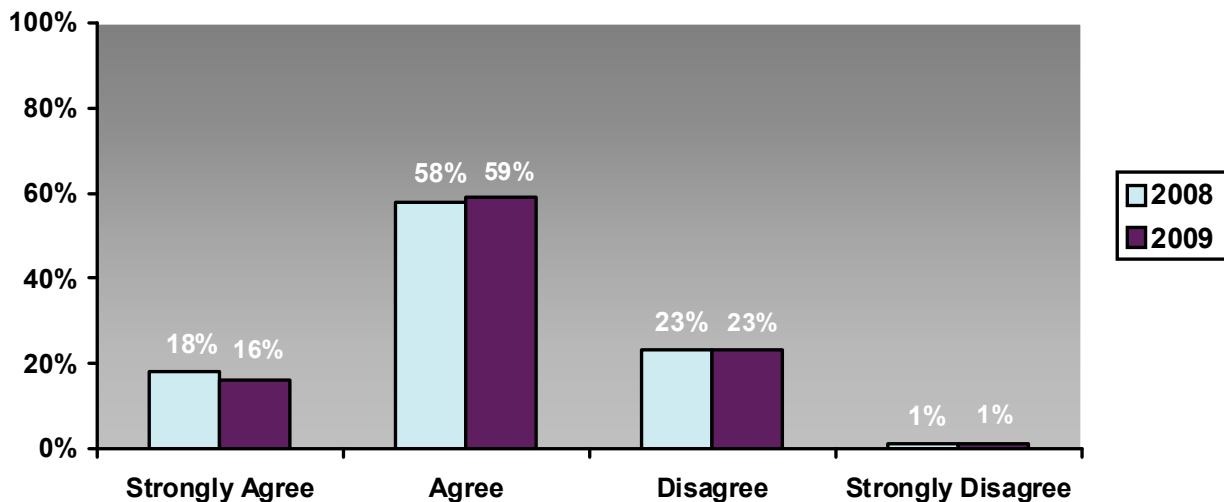
- After an unexpected decrease in interest in Asia in 2008, our 2009 survey saw an increased interest in the region with 58% choosing Asia as a region poised for economic growth. With 21% choosing North America as a region poised for growth, it is clear that respondents continue to look to these two regions as the dominant players.
- We found it interesting that respondents expressed higher interest in South America in 2008 and 2009, while increase in Europe is declining. Along these lines, the debut of Banco Santander Brasil on October 6, 2009 marked the world's largest IPO since March 2008 and the largest IPO ever in Brazil.



Have you witnessed an increase in the prevalence of foreign investors within the last 12 months?



To what extent do you agree with this statement: I expect foreign investment to increase in the coming year as current economic conditions persist in the U.S.



- Respondents continue to anticipate an increase in foreign investment, with the majority (76%) agreeing with this notion in 2009. However only 37% indicated an increased



prevalence of foreign investors within the last 12 months, compared to 52% who agreed with this statement in 2008.

- This indicates that although we have not yet seen it materialize, respondents are still anticipating a pick-up in foreign investment when the U.S. market rebounds.



METHODOLOGY

In September of 2009, 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 230 respondents.

The demographic make-up of respondents includes 40% outside consultants/advisors, 52% emerging company executives and 8% investors.

The survey coincides with Foley's 2009 Emerging Technologies Conference held in Boston on October 15, 2009 and San Diego on September 30, 2009, which are attended by many of the respondents completing the survey.

For updates regarding the survey results and breaking emerging technology news, follow us on Twitter at <http://twitter.com/FoleyTech>.

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

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