

## Early-Stage Fundings Fuel VCs in 2006

by Carolyn Murphy Posted 06:36 EST, 22, Jan 2007

In a year of record post-bubble venture investment, startups pulled in nearly \$26 billion in 2006, but they closed out the year with their slowest quarter since 2005, according to two industry reports out this week.

In 2006, financings reached their highest levels since 2001 and represented the third consecutive year-over-year increase in VC investment, according to the MoneyTree Report by **PricewaterhouseCoopers** and the National Venture Capital Association, based on data from **Thomson Financial**.

Venture capitalists poured \$25.5 billion into 3,416 deals in 2006, 12% more than the \$22.8 billion that 3,100 companies pulled in during 2005.

Investment for the fourth quarter, which totaled \$5.7 billion spread across 802 deals, was down from the \$6.6 billion invested in 862 deals in the previous quarter — and the lowest for any quarter in 2006 — but it marked a slight, \$20 million increase over the fourth quarter of 2005.

Among the trends for the year, seed and early-stage deals commanded attention, energy further firmed up its footing as an investment sector, and first-time financings hit a post-bubble high.

In 2005, 990 later-stage companies had venture rounds, a number that dropped to 957 in 2006, according to the MoneyTree Report. Historically, it's pretty high, accounting for about 28% of deals in the year, but it is down from about 32% of deals a year earlier, according to NVCA vice president of research John S. Taylor. In a conference call to discuss the results, he called the drop a positive sign, saying: "Venture capitalists are able to turn their attention from these projects that have been going on for several years to the next crop of companies." But he warned there's still weight toward the later-stage companies.

Seed and early-stage deals jumped to 1175 from 1018 a year earlier, data shows.

**Menlo Park, Calif.-based US Venture Partners' Steve Krausz** acknowledged during the call that VCs have returned to early-stage investing, likening what he saw in late 2005 and early 2006 to "barbell investing," with more early- and late-stage companies drawing investment, and a dearth in B and C rounds.

"What we saw in '06 was a return to early-stage. I think it is some of the freeing up of capacity," Krausz said. "I also think it represents a better valuation scenario and a better M&A environment. Acquirers have been willing to pay a little bit more, and the IPO market, although it was small in numbers, has picked up a little bit."

Additionally, first-time financing rounds grew from 991 in 2005 to 1,093 in 2006, a post-bubble high.

For the year, life sciences was the biggest winner with \$7.2 billion in 731 deals, up from \$6.0 billion across 647 deals in 2005.

Boston-based **Polaris Venture Partners'** Terry McGuire said during the call that the growth in life sciences is due to three things: positive M&A exits as well as companies that had gone public in earlier years doing well, so evidence of dollars well-invested; an increased need from pharmaceutical and med tech companies for products to fill their pipeline; and later-stage deals.

Some hot life sciences areas right now, McGuire said, include: platform technologies, proteins, startups addressing pandemics and products, and smart devices to deliver therapeutics and spinouts. "If I look at 2007, I expect it to be a lot like 2006 — a good year of growth, a good year of opportunity," he said.

For other sectors, industrial/energy jumped more than twofold — 183 companies took in \$1.8 billion, compared to 136 companies tapping \$851 million in 2005. Alternative energy accounted for 40% of the overall investment. And in media and entertainment, 299 deals took \$1.6 billion, above the 180 companies pulling in \$1 billion a year earlier. In telecom, 294 deals netted \$2.6 billion in 2006, up from 263 deals taking in \$2.5 billion a year earlier. Wireless deals accounted for 44%.

Of the 10 largest deals of the year, four were in telecom, three in energy and three in biotech. Goshen, Calif.-based **Cilion Inc.** pulled in the most money for the year — \$209 million in the third quarter. California grain milling company **Western Milling**, Menlo Park, Calif.-based **Khosla Ventures**, the VC vehicle of **Sun Microsystems Inc.** co-founder Vinod Khosla, formed the ethanol technology company to build ethanol plants. Rounding out the top three, Beverly Hills, Calif.-based mobile entertainment provider **Amp'd Mobile Inc.** took \$152.7 million in the second quarter from **Columbia Capital LLC**, **Highland Capital Partners LLC**, **Redpoint Ventures**, **Tudor Ventures** and **Rho Ventures**, while Internet content delivery company **Limelight Network Inc.** of Tempe, Ariz., took a \$130 million first-round of backing from **Goldman, Sachs & Co.** and **Oak Investment Partners** in the third quarter.

Looking ahead, some IT areas of interest Krausz expects for 2007 include wireless infrastructure, wireline growth driven largely by video, monetizing ad revenue in video and social networking, as well as casual gaming, business analytics and software as a service.

Findings from **Ernst & Young LLP** and **Dow Jones & Co.**'s Venture One were roughly aligned, with 2,454 deals pulling in \$25.75 billion, 8% more than 2005. In the fourth quarter, data shows, 561 deals pulled in \$5.82 billion.