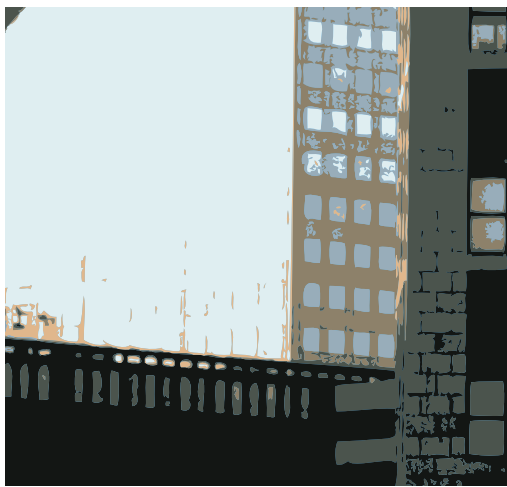
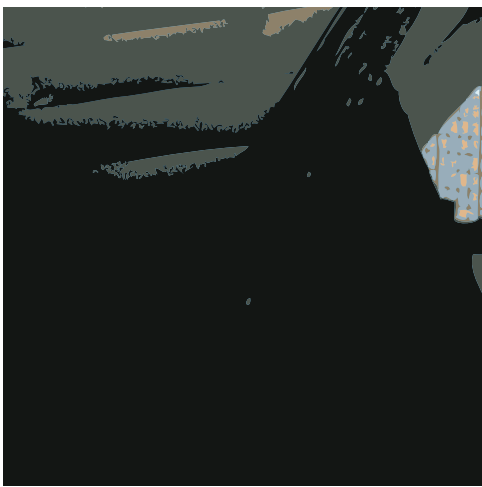
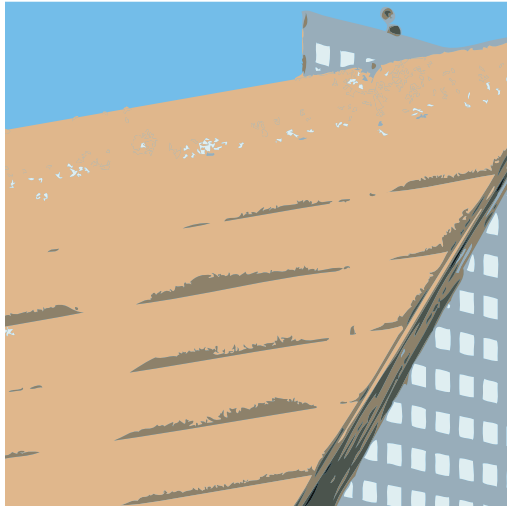


DENVER VENTURE CAPITAL REPORT

2013





DENVER
OFFICE OF ECONOMIC
DEVELOPMENT



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Disclaimer

The designations employed and the presentation of the material in this document do not imply the expression of any opinion whatsoever on the part of the City of Denver and the Innovation Pavilion. The information contained herein is based on current information that the researchers and the supervisor consider reliable, but we make no representation that it is accurate or complete, and it should not be relied upon as such. It is provided with the understanding that the School of Management is not acting in a fiduciary capacity.

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Executive Summary

This report evaluates the state of venture capital investment in metro Denver from 2008 to 2012. The report focuses on a historical analysis, a comparison between metro Denver and other venture hubs, the funding levels at each business stage, the distribution of funding in each sector and the exit activities.

Over the period under review, the venture capital activities experienced a sharp decline from a high of \$300 million in the first quarter of 2008 to a low of \$60 million in the fourth quarter of 2012, attributed to the economic downturn. During the last two years, however, the landscape slightly improved with investments averaging \$125 million as the economy showed signs of recovering. Metro Denver ranked eighth in the number of deals and ninth in investments when compared to nine other select venture capital hubs over the last five years. A shift was observed in the financing patterns. More capital was channeled into early and later business stages with minimal financing at the seed stage. This pattern could be explained by the high risk associated with the seed stages. The capital funds in the expansion stage were low due to diminished demand for expansion capital resulting from low economic activity. The technology and healthcare sectors were the beneficiaries of most of that capital. A study of the exits revealed that most occurred through mergers and acquisitions.

Introduction

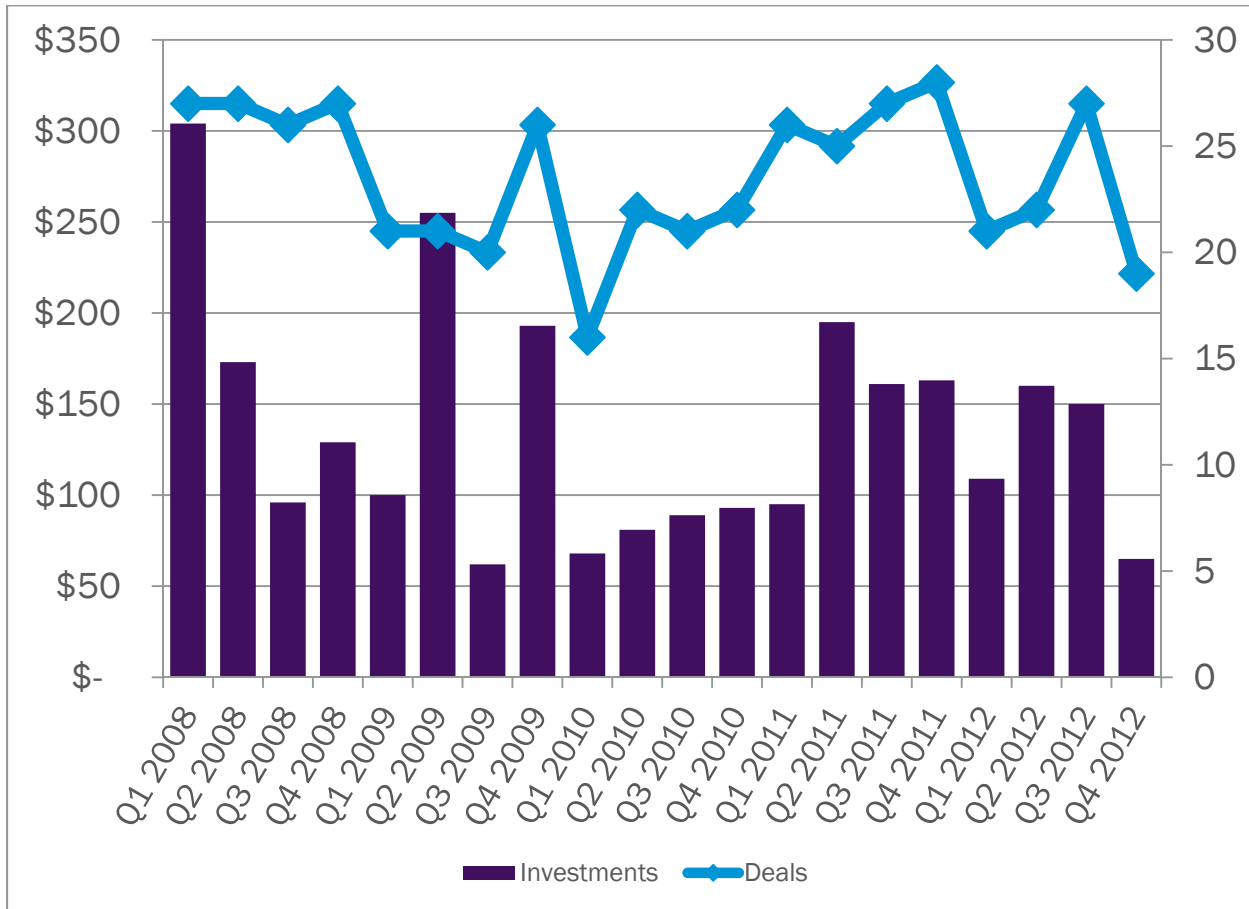
The U.S. economy has, over the past decades, shifted from a manufacturing to a technology and services-based economy populated by small businessesⁱ and growth companiesⁱⁱ. In addition, small businesses are playing a significant role in reducing unemployment and helping local economies prosper. Small businesses on average create 64% of the new private sector jobs, employ over 50% of all the workers and contribute more than 50% of the national outputⁱⁱⁱ. The number of jobs created by companies established within the last 12 months was 2.5 million in 2010. During the same year, according to the Kauffman Foundation, an average of 0.34 percent of adults created a new business each month, equaling about 565,000 new businesses per month^{iv}. In Colorado, about 97% of employer companies are small businesses and the vast majority of them have fewer than 20 employees^v.

For this reason, the City and County of Denver views the encouragement and support of businesses as a catalyst to creating new jobs and growing a vibrant economy. Key to this effort is a strong structure that supports access to funding. Consequently, the Denver Office of Economic Development, in partnership with the Innovation Pavilion, commissioned a study by Regis University students under the supervision of Dr. Luka Powanga to review the state of venture capital in Denver over the past five years and to compare the city with other venture capital hubs. The results of this study are outlined in this document.

Five-Year Venture Capital Financing History

Figure 1 depicts the number of deals and the total value of the deals from 2008 to 2012. During this period, the largest activity in terms of number of deals occurred in the fourth quarter of 2011 when 28 deals were conducted with the lowest occurring in the first quarter of 2010 when only 16 deals were consummated. The largest total value of venture capital occurred in the first quarter of 2008 at \$304 million with the lowest value of \$62 million recorded in the third quarter of 2009. Overall, venture capital investments went through a turbulent period resulting in a sharp decline in transactions and investment levels from 2008 to 2010. From 2010 to 2012, the situation showed signs of improvement; in general, however, the activities remained erratic largely attributed to the country's weak economic performance. The continued economic performance is expected to buoy these transactions.

Figure 1: Five-Year View Financing Activity (\$Millions)

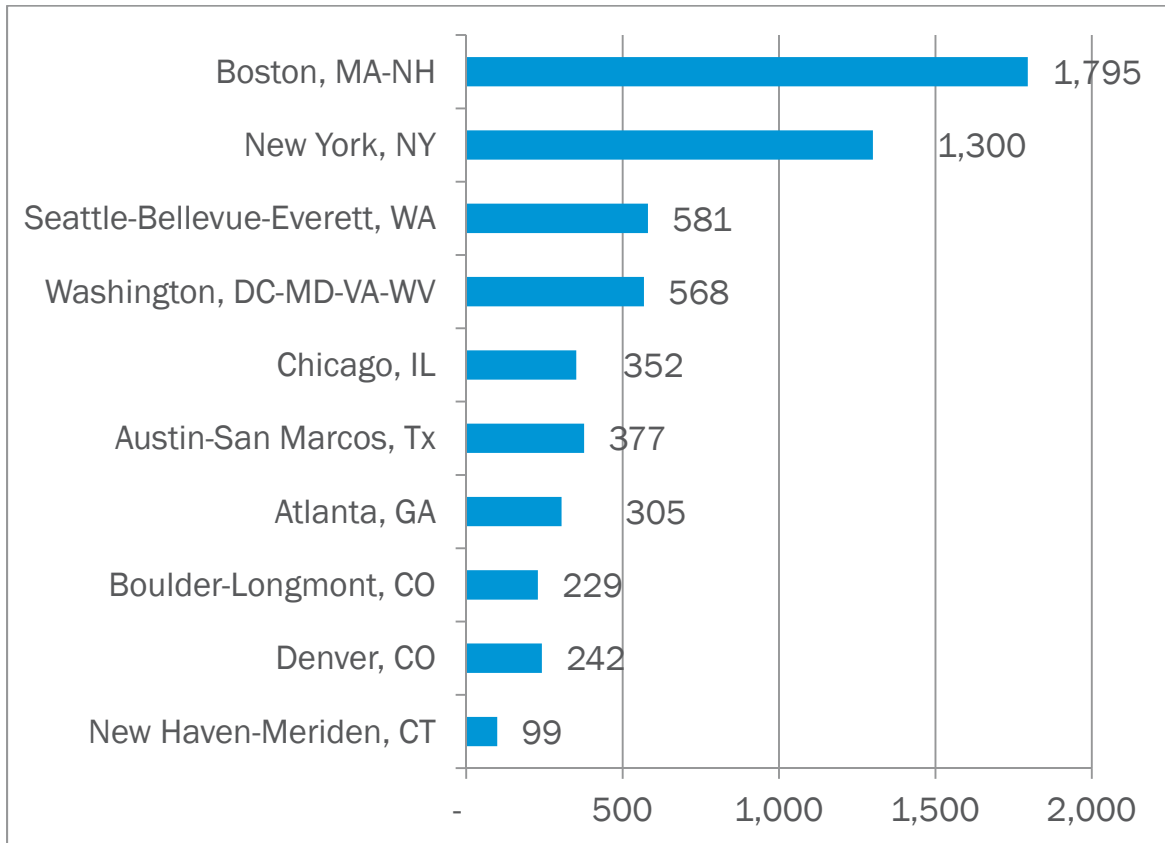


Source: PricewaterhouseCoopers (PwC)/National Venture Capital Association (NVCA) MoneyTree™ Report;
 Data: Thomson Reuters, Denver Investments by Year Q1 2008 – Q4 2012

Benchmarking Metro Denver Against Other Venture Capital Hubs

Metro Denver venture capital activity, at more than \$1.3 billion, ranked eighth in number of deals and ninth in the value of the venture capital disbursed when compared with nine other select venture capital hubs from 2008 to 2012¹ as depicted in Figures 2 and 3. If metro Denver and Boulder-Longmont were combined as one hub, they would rank fifth in number of deals and in investments. Peak years for Denver were 2008, 2011 and 2012. Denver's ranking exceeds Boulder-Longmont's in number of deals; however, venture capital investments in Boulder-Longmont exceeded those in Denver. The average investment per deal in Boulder-Longmont exceeded that in Denver by almost \$890,000. Investment activity factors include the hub's marketing and the number of local venture capital investors. Technology-based firms that do not need to be physically located near customers or in larger cities may locate in less established areas due to tax incentives, lower overhead costs and space for development.

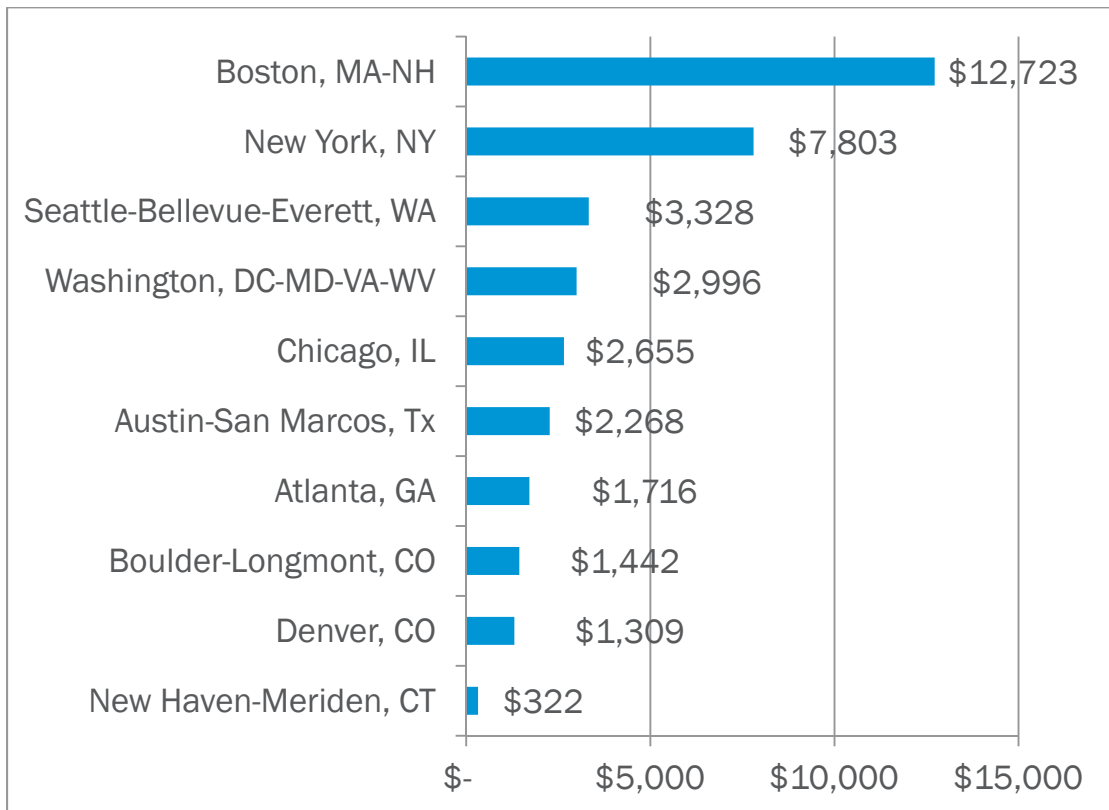
Figure 2: Deal Counts-Metro Denver Against Other Capital Hubs (2008–2012)



Source: PwC/NVCA MoneyTree™ Report; Data: Thomson Reuters, MSA from 2008–2012

¹ The Silicon Valley hub was not included.

Figure 3: Investment Levels-Metro Denver Against Other Capital Hubs, 2008–2012 (\$Millions)

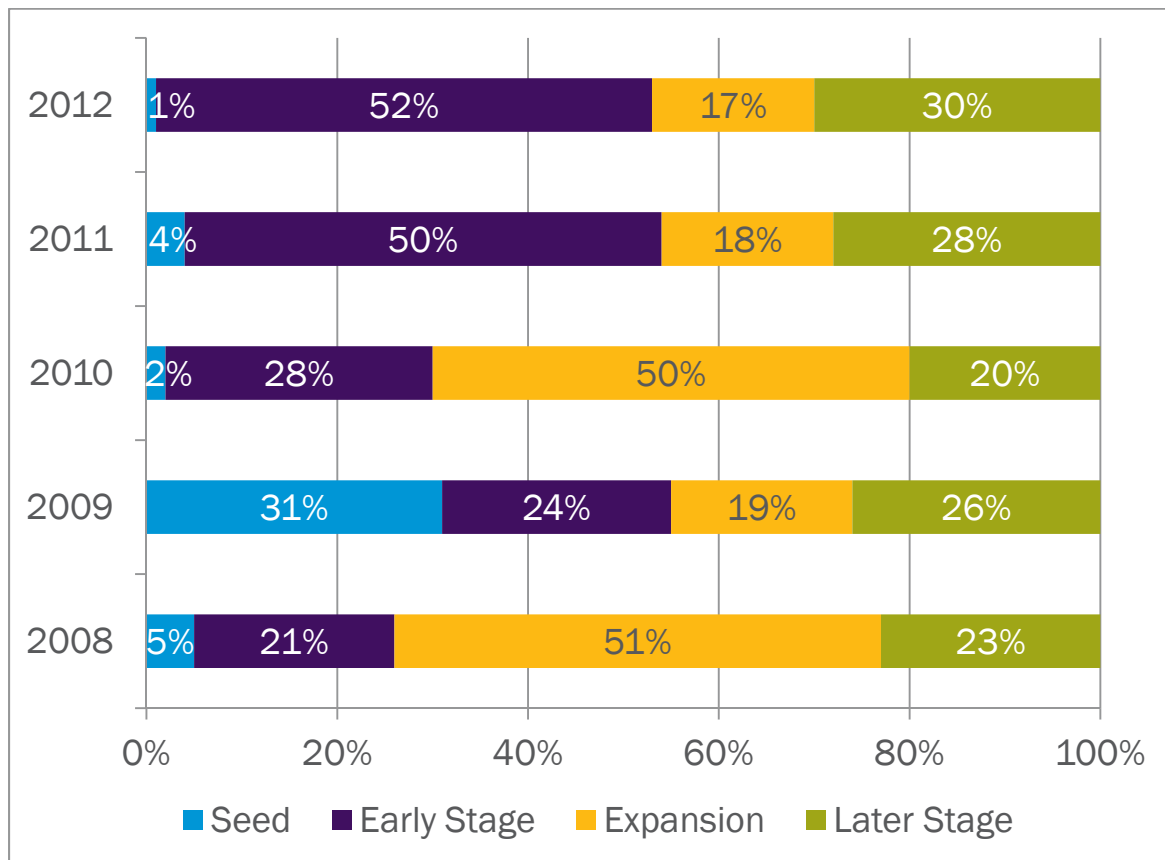


Source: PwC/NVCA MoneyTree™ Report; Data: Thomson Reuters, MSA from 2008–2012

Venture Capital Financing by Stage

Figure 4 illustrates the changes in the financing patterns by stage. The investment activity has shifted dramatically away from the expansion stage to early stage development. In 2008, expansion investments represented 51% of total investment allocation, although this figure declined to 17% in 2012. Over the same period, early stage investments have grown from 21% of investments in 2008 to 52% in 2012. This trend signals good news for upstart companies needing capital in order to fund the large upfront costs of research, development and marketing. Shifting focus toward these earlier stages will help small companies develop while offering investors larger returns to compensate for added risk. Secondly, seed-stage companies have seen dwindling support in recent years as these companies are still within the planning stage of development and represent larger risk. Four percent of investments went to helping seed-stage ideas take shape, which steadily shrunk to only 2% in 2012. This trend will make it more difficult for ventures to take shape until the product, idea, or service is more developed.

Figure 4: Metro Denver Financing by Stage



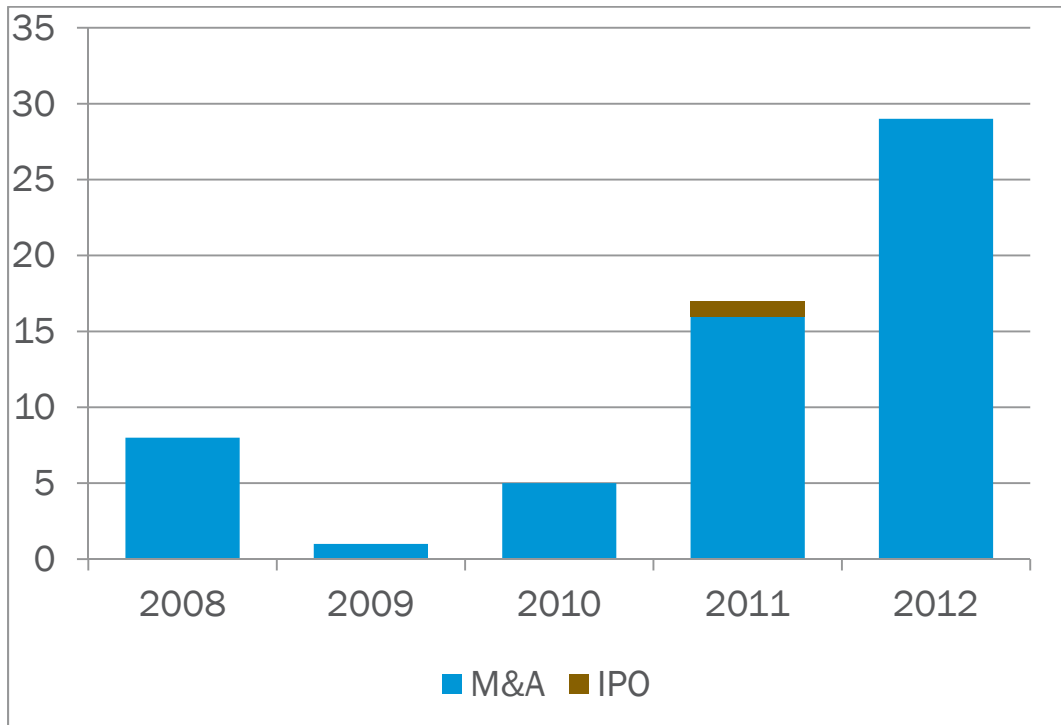
Source: PwC/NVCA MoneyTree™ Report; Data: Thomson Reuters, Investments in Denver by Stage of Development 2008 – 2012

Analysis of Exit Activity in Denver

This section discusses the activities pertaining to the options that metro Denver companies seeking to raise capital for increasing investments, adding infrastructure or operational needs may utilize—focusing on initial public offering (IPO), merging with another company, and acquiring a competing or similar company.

Figure 5 illustrates the number of exit activities in Denver for the 2008–2012 period. During this period, 60 exits were recorded with all but one being a result of merger and acquisition (M&A). Only one exit was due to issuing an IPO activity (2011). During the period under review, the exit activities picked up after a decline in 2008. The decline was due to a depressed economic performance during that year. The exit activity picked up after the economy showed signs of recovering later in the year. There were two notable IPOs between 2008 and the first quarter of 2013. The first was Bonanza Creek Energy from the energy and utilities sector, which had an initial public offering of \$170M in December 2011. The second, though outside the period under review (2008–2012), was HF2, which went public in the first quarter of 2013 with an IPO of \$153M. As the economy strengthens, IPO and M&A activities are expected to increase.

Figure 5: Number of Exit Activities (2008-2012)



Source: CBInsights, 2011

Venture Capital Funding by Sector

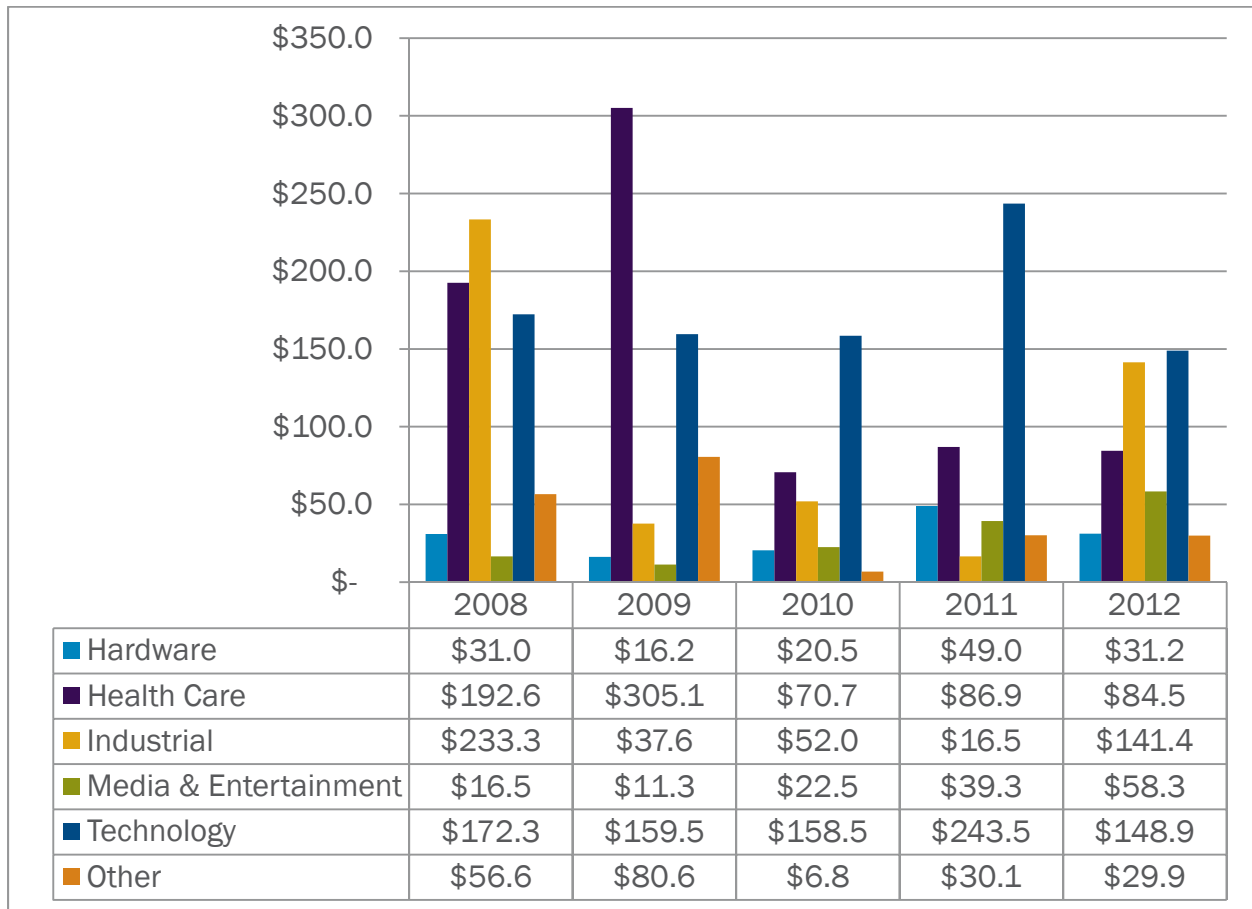
To carry out the analysis, the sectors were segregated into different categories following the guidelines from the City and County of Denver:

- Hardware: computers, peripherals, electronics & instrumentation
- Healthcare: biotechnology, healthcare services, medical devices & equipment
- Industrial: industrial, energy & semiconductors
- Media & entertainment
- Technology: IT services, networking & equipment, software & telecommunications
- Other: business & consumer products and services, financial services, retailing & distribution²

The investment levels in each sector are given in Figure 6. The healthcare and technology sectors were the highest funded. The industrial industry showed a decline in 2009 and 2010 and improved in the last two years. Hardware, media & entertainment and the “other” category were the least funded.

² (MoneyTree, 2012)

Figure 6: Investments by Sector (\$Millions)



Source: PwC/NVCA MoneyTree™ Report; Data: Thomson Reuters

A graphical representation of the distribution of investment in each sector as a percentage of the total investments in each of the years under review is depicted in Figure 7. This chart clearly demonstrates that healthcare and technology industries received the most venture capital funding, while “other” industries and hardware received a lower percentage of the funding dollars.

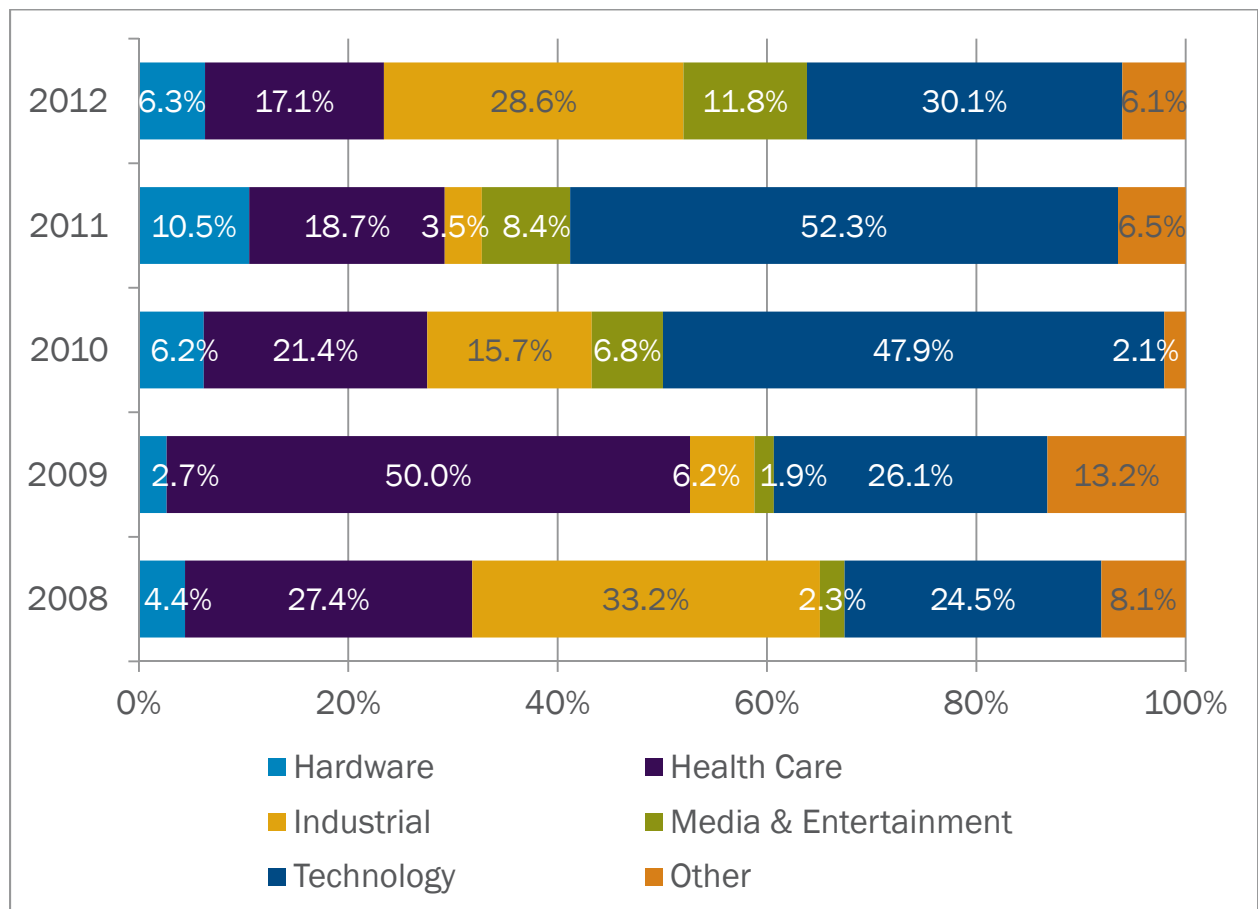
To understand the funding patterns in each of the sectors, data on the number of transactions was obtained to determine the sectors with high capital outlays. The results are documented in Figure 8. The healthcare sector, despite dominating in the investments received, had very few transactions. This suggests that the amount per transaction was high, which could be attributed to high capital costs per project undertaken as seen in Figure 9. In contrast, the technology sector had the highest number of transactions, leading to the conclusion that the value of each transaction was low. This could be explained by the low capital outlays needed for equipment.

The data suggests that the most successful industries in Denver are healthcare and technology with industrial and hardware following closely behind. The most lagging industries are “other” and media & entertainment.

Analysis of Denver’s Most Well-Funded Companies

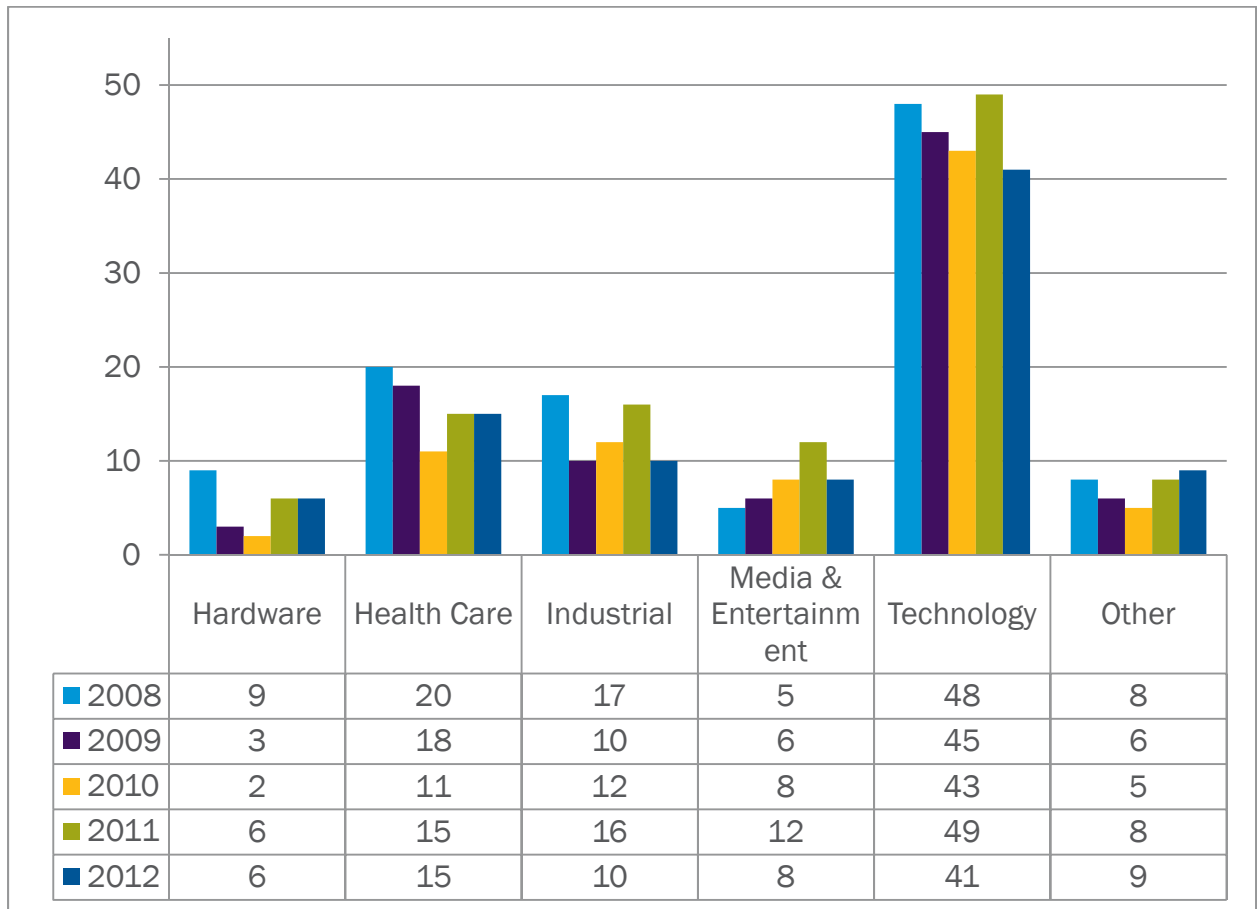
This section reviews information on the most well-funded companies in Denver over the past five years (2008-2012). From Figure 10, the funding among the top nine companies varied from \$21.3 million by Coolerado to \$60.3 million by T3 Media until in 2013 when Jagged Peak Energy received \$400 million from the Quantum Energy Investors based in Houston, Texas. The capital injection from Quantum Energy investors catapulted Jagged Peak Energy to the top slot, as it accounted for more than 50% of the total funding over the six-year period as depicted in Figure 11.

Figure 7: Sector Investments as Percentage of Total Funding



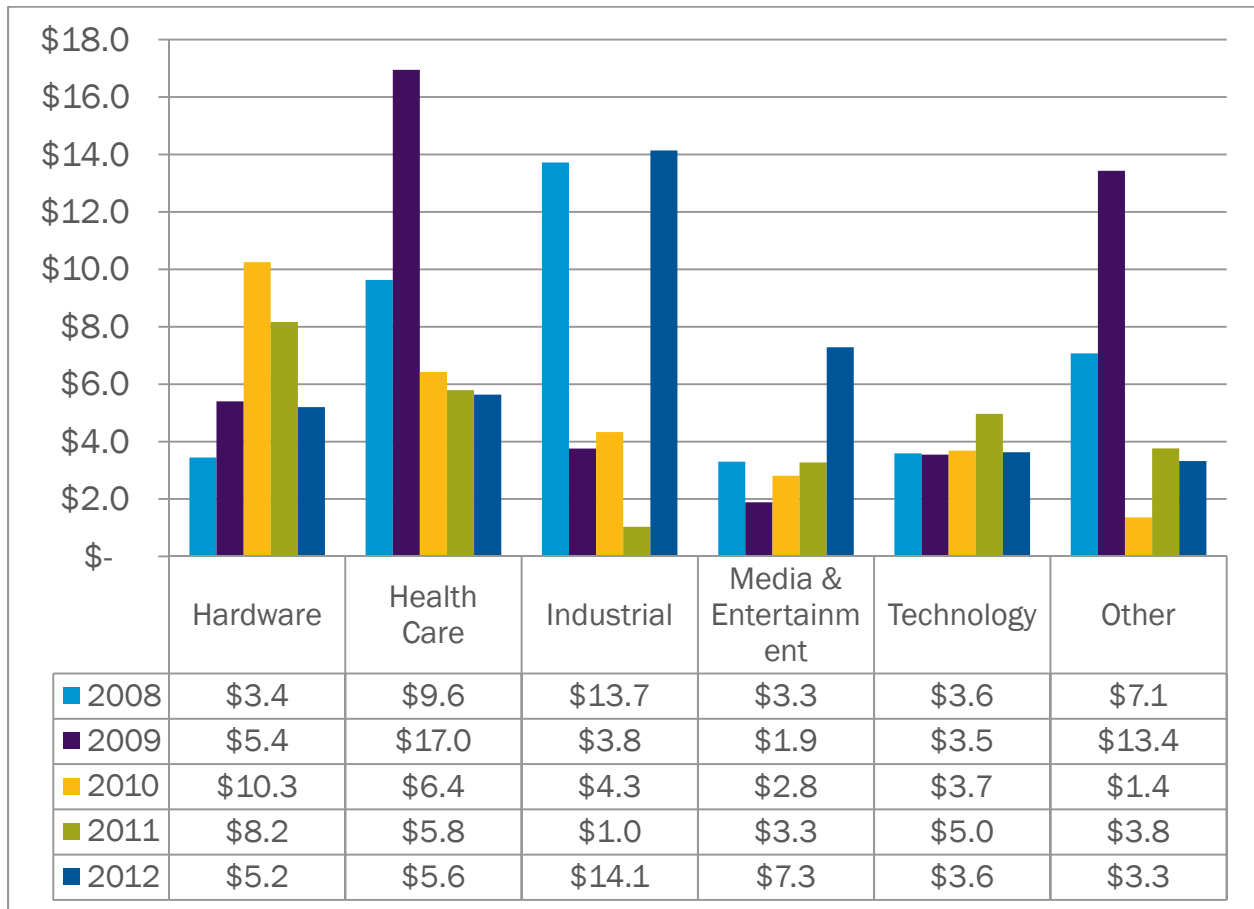
Source: Computed from data obtained from PwC/NVCA MoneyTree™ Report; Data: Thomson Reuters

Figure 8: Transactions by Sector



Source: Computed from data obtained from PwC/NVCA MoneyTree™ Report; Data: Thomson Reuters

Figure 9: Average Investment per Transaction (\$millions)



Source: PwC/NVCA MoneyTree™ Report; Data: Thomson Reuters

Top Venture Capital Investors in Denver

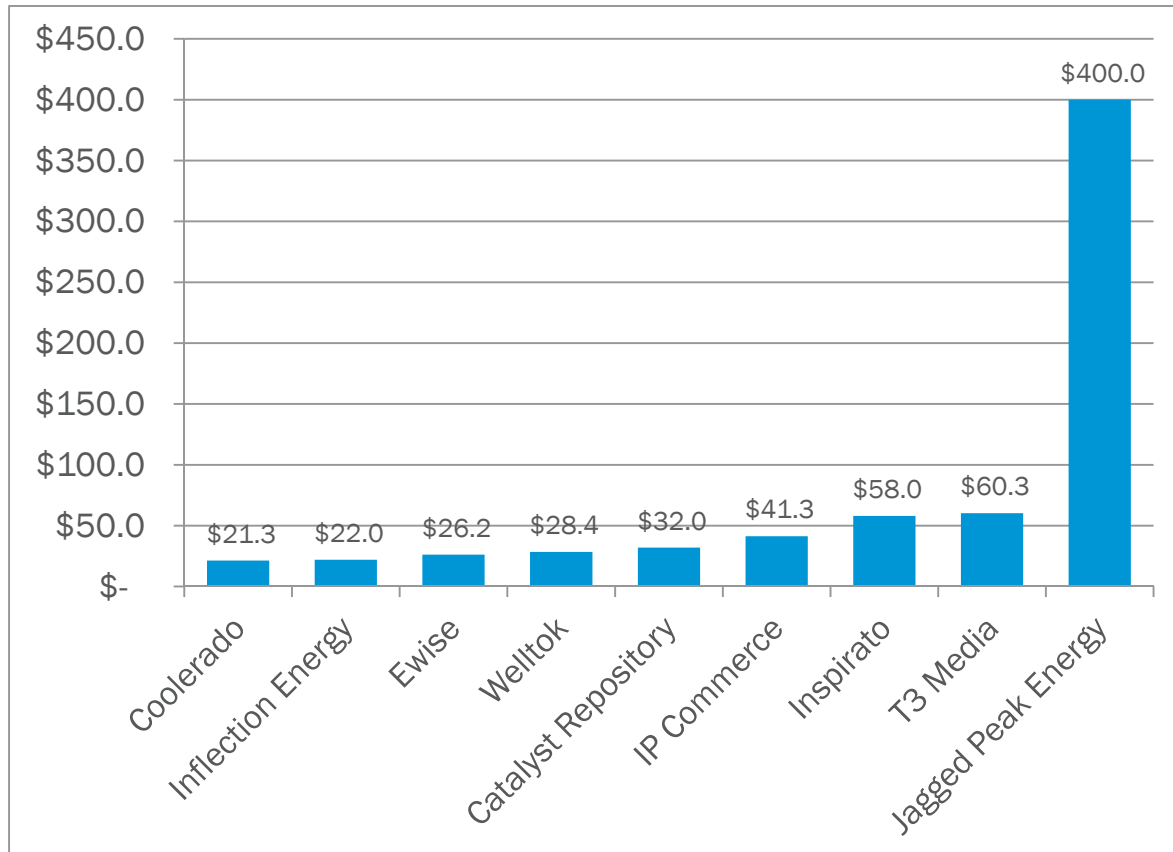
Metro Denver’s top venture capital companies between 2009 and 2013 are given in Figure 12. These firms tend to specialize in different sectors and business stages. Altira Group focuses on technology companies in the oil and gas industry, while the Foundry Group, located in Boulder, invests largely in human-computer interaction (interactive video games) with the portfolio consisting of companies like Zynga, Sifteo, Harmonix and Orbotix.

Notable Private Company Exits

The exit activity pertains to IPO, buy-outs (BO), M&A, as well as equity investment-partnerships (EI-P). It should be noted that companies may choose to remain private, and thus avoid the scrutiny and

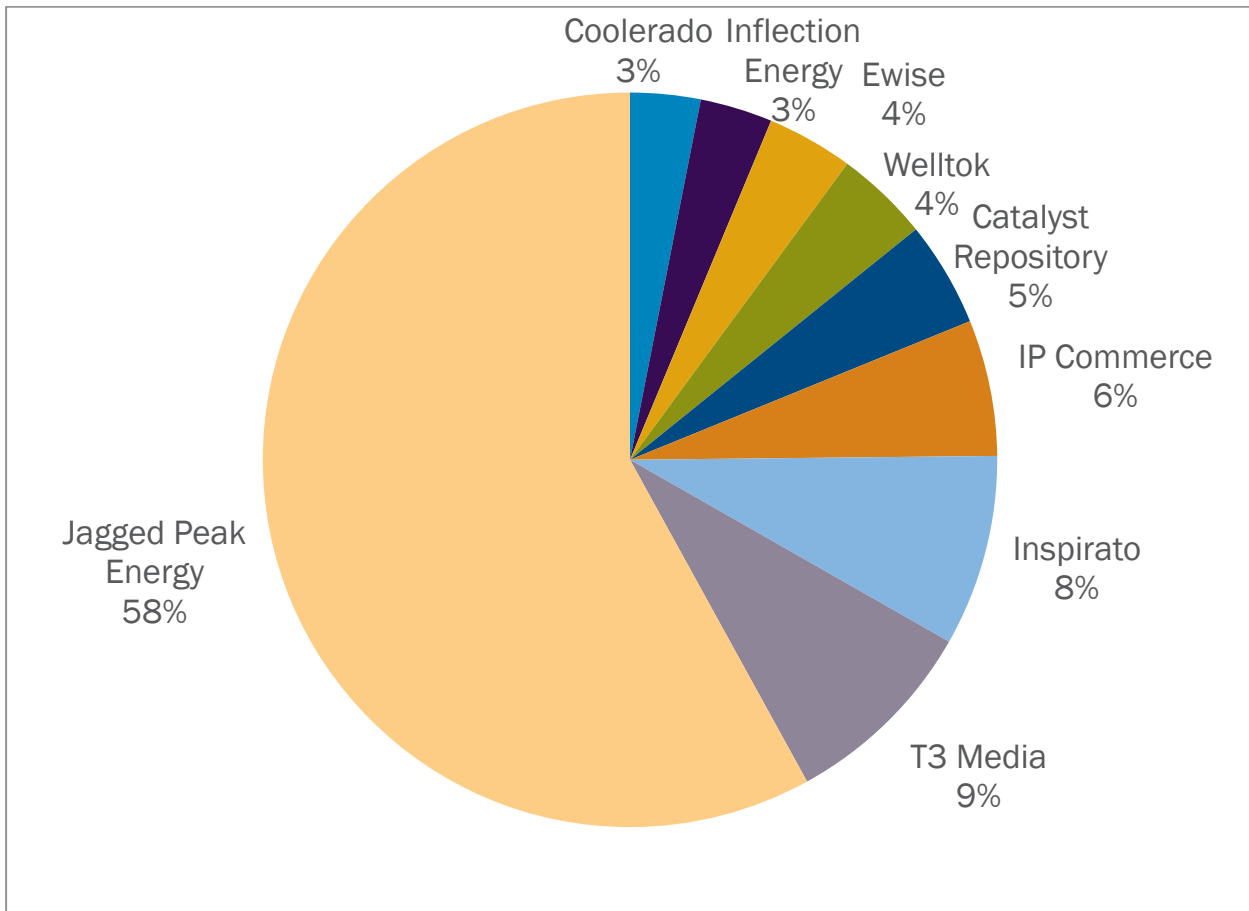
disclosure requirements faced by public companies. Private companies may continue to grow through private funds acquisition if needed. The notable private company exits (Figure 13) were developed for the 2008–2012 period based on the company valuation exceeding \$10 million.

Figure 10: Individual Company Funding (\$Millions)



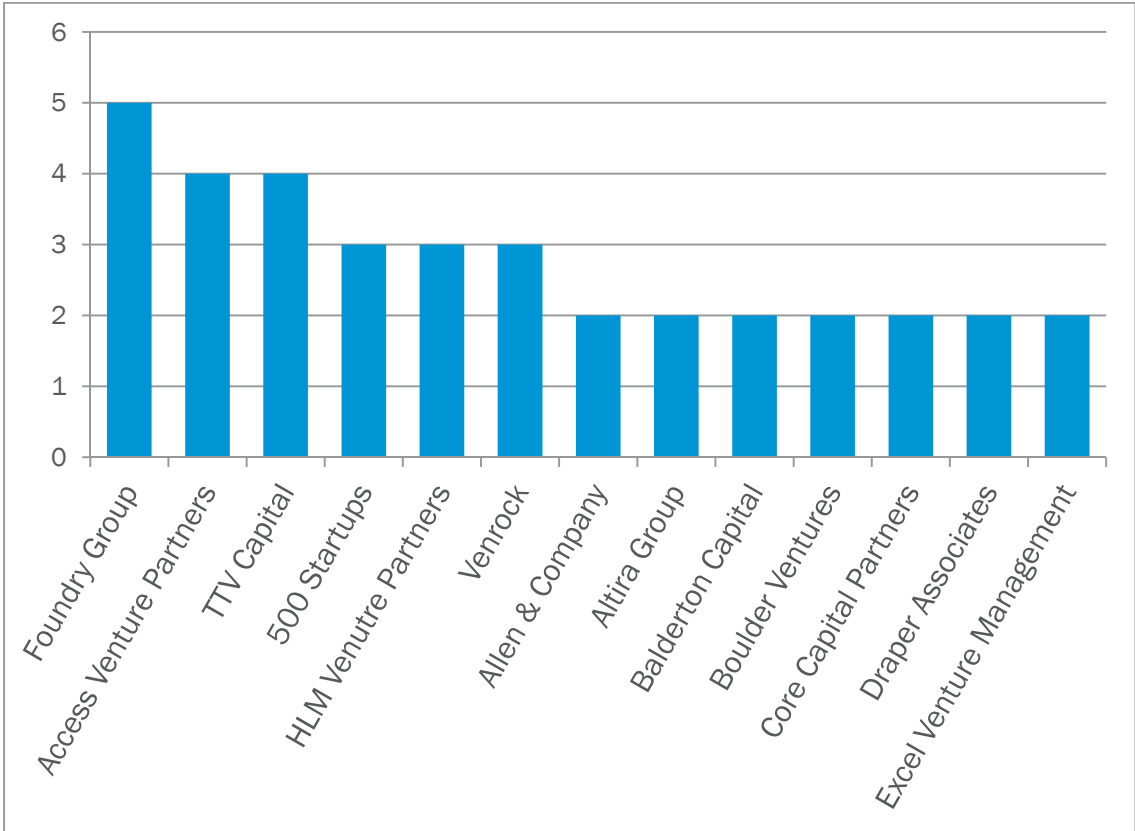
Source: Computed from Data from CBInsights, 2013

Figure 11: Funding Distribution Among Top 10 Companies



Source: Computed from Data from CBInsights, 2013

Figure 12: Deals Consummated by Top Venture Capitalists (2009-2013)



Source: www.Xconomy.com

Median and Average Venture Capital Deals in Denver

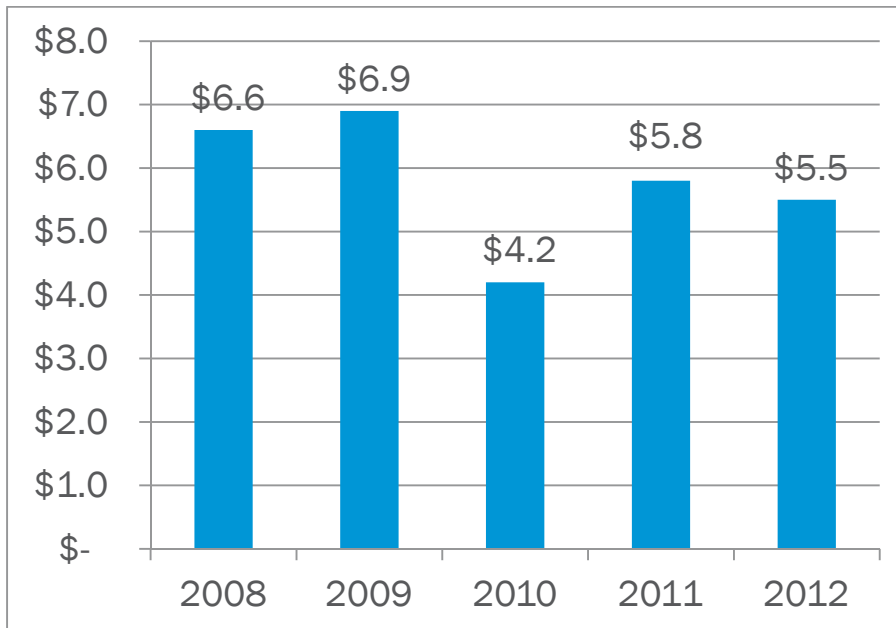
The average deal size was higher in 2008 through 2009 and declined toward 2012 (Figures 14 and 15) attributable to the sputtering economy. The median deal size followed a similar pattern. Overall, the numbers are expected to increase as the economy continues to improve.

Figure 13: Notable Venture Exits (2008-2012)

Target	Acquirer (Venture Investor)	Valuation (\$M)
Associated Content	M&A-Yahoo!	\$90
Inflection Energy	Good Energies	\$40
Catalyst Repository	FTV Capital	\$32
Thought Equity Motion (T3 Media)	Shamrock Holdings	\$25
Ping Identity	Silicon Valley Bank, Draper Fisher Jurvetson, Volition Capital, General Catalyst Partners, SAP Ventures, Triangle Peak Partners	\$21
IP Commerce	Intel Capital, Meritage Funds, Venrock	\$20.7
Inspirato	Institutional Venture Partners	\$20
Inspirato	Access Venture Partners, CrunchFund, Kleiner Perkins Caufield & Byers	\$17.5
PaySimple	Susquehanna Growth Equity	\$16
Inspirato	Undisclosed	\$15.5
Sympoz	Foundry Group, Harrison Metal Capital and Tiger Global Management	\$15
eWise Systems USA	Wellington Partners, Balderton Capital, TTV Capital	\$14
Aventura	HLM Venture Partners, Excel Venture Management, Siemens Venture Capital	\$13
eWise Systems USA	Balderton Capital, Allen & Company	\$12.1
Inspirato	Undisclosed	\$11
WealthTouch	Undisclosed	\$11
Channelinsight	Rho Ventures, Sevin Rosen Funds, Sequel Venture Partners, Vedanta Capital	\$10

Source: www.xconomy.com

Figure 14: Average Deal Sizes for Exits (\$Millions)



Source: PricewaterhouseCoopers-personal communication

Figure 15: Median Deal Size (\$Millions)



Source: PricewaterhouseCoopers-personal communication

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Definitions

In this report, the following definitions were used:

Denver: Metro Denver

Business Stages:

- Seed: A firm that is still on the bench and may therefore need seed or startup capital for proof of concept, research or feasibility studies.
- Early Stage: A firm that is ready to go to the market.
- Expansion Stage. A firm that is immediately ready for production or currently in production but needs capital to expand the operations. Though the company is in production, little or no profits have been realized.
- Later Stage: The firm is in production and has made profits but needs capital for expansion, establishing new markets, new supply chains, etc.

ⁱ Classified by the Small Business Administration as firms with less than 500 employees

ⁱⁱ Conte and Carr, "Outline of the U.S. Economy" published by the US Department of State

ⁱⁱⁱ Shane Scott, How Many Jobs Do Small Employers Create?, 2009, Bloomberg Business Week.

^{iv} www.sba.gov accessed March 27, 2013

^v <http://www.denverchamber.org/Page/smallbiz>, accessed March 28, 2013