

FAIRVIEW

CAPITAL

COMPUTING IN THE CLOUDS

FAIRVIEW NEWS

► Fairview Co-Founder and Managing Director JoAnn Price is a proud honoree of The Women of Power Legacy Awards dinner which is part of the fourth annual Women of Power Summit being held in Orlando, Florida from February 11th-14th. The Women of Power Legacy Awards honor women who have opened doors, broken barriers, and rewritten the standards of success for women of color in every field. Joining JoAnn as honorees this year are: Dr. Joycelyn Elders, former U.S. Surgeon General, Leah Chase, owner of Dooky Chase restaurant, and Mary Frances Berry, Ph.D., a Geraldine R. Segal professor of American social thought and professor of history at the University of Pennsylvania.

► Fairview is pleased to announce that Dr. Kola Olofinboba has been promoted to Partner. Kola joined Fairview as a Principal in 2007 from McKinsey & Company's Boston Office, where he had served global clients in private equity, health-care and consumer goods. Earlier in his career, he practiced medicine as a hospitalist and assistant professor at the University of Connecticut Health Center in Farmington, CT winning multiple teaching awards.

Arguably, the area generating the most buzz in the information technology sector is cloud computing. Yet, for all the attention cloud computing has received, there is still a lot of debate about what it actually is. The "cloud" is a metaphor for the Internet and, at the very basic level, cloud computing refers to programs that are designed to run over the Internet, with the actual computing power housed elsewhere. However, the context in which the term cloud computing is used has varied greatly. Very broadly, it has been used in reference to anything consumed outside of a firewall. In a more specific way, the term has been used to narrowly describe an aspect of the technology, such as software as a service, platform as a service, or even grid and utility computing.

A more meaningful way of understanding and thinking about cloud computing is to look at the factors that actually make the technology impactful. In this sense, cloud computing is really the convergence of three major trends: virtualization, utility computing, and software as a service. All three trends have reached a point in their evolution where their convergence allows cloud computing to become an efficient and effective information technology.

Virtualization is a broad term that refers to the abstraction of computer resources. Specifically, server virtualization allows multiple operating systems to run concurrently on the same hardware, each capable of performing independent functions. From a business perspective, virtualization allows for a reduction in operating costs and capital expenditure by consolidating hardware in data centers.

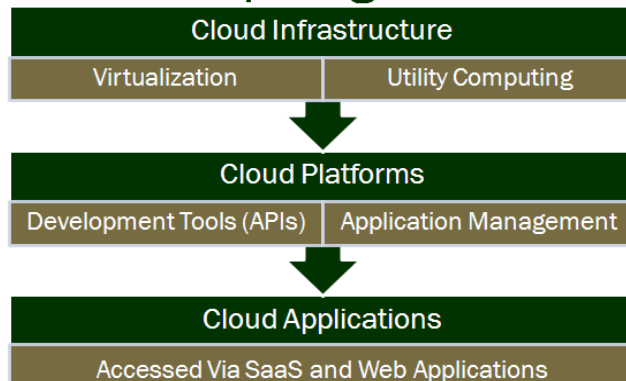
Utility computing is the packaging of computing resources, such as computation and storage, into a metered service similar to a traditional public utility like electricity or water. This system has the advantage of a low or zero initial cost to acquire hardware for the end user; instead, computational resources are essentially rented and accessed over the Internet. Utility computing often incorporates virtualization – companies such as Amazon offer both storage and virtual servers that can be accessed on demand. Early enterprise adopters have mainly used utility computing for supplemental, non-mission-critical needs but in the future, it may replace entire data centers. For entrepreneurs, utility computing has substantially reduced the amount of capital outlay required to start a web or information technology related business.

Software as a service (SaaS) delivers a single application, primarily through a browser, to a multitude of customers using a universal architecture. These shared applications are available on demand and paid for on a subscription basis. By eliminating the need to install and run the application on the customer's own computer, SaaS alleviates the customer's burden of software maintenance, ongoing operation, and support. The best known example of an enterprise-level

SaaS provider may be Salesforce.com, a former Fairview portfolio company that went public in 2004. Salesforce.com was originally launched as a provider of Customer relationship management SaaS, but is now offering a platform as a service product through its Force.com, which more closely resembles a complete cloud computing model. Similar to Amazon.com's Amazon Web Services, Force.com allows users to build and host custom applications. For example, an enterprise may use the service for supply chain management or human resource management applications tailored for their business. These services also allow users to store and retrieve large amounts of data to go along with the applications, all on demand, while paying only for what they use with no up-front costs.

The coming-together of virtualization, utility computing and SaaS, combined with the widespread availability of broadband Internet connections, has opened the door for cloud computing to truly become viable and change the information technology landscape. This potential will be better appreciated if SaaS eventually broadens to include all web applications that host individual user data, which would create countless potential end-users of cloud computing. Further, cloud computing today is a bit of a misnomer because it is still fragmented – there are a number of isolated clouds of service such as Amazon's or Salesforce's, which users must plug into individually, but there is no one singular cloud of interconnectivity. However, this is changing as an increasing number of providers are open source and are offering solutions for integration across multiple platforms.

Cloud Computing Value Chain



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FAIRVIEW NEWS

Fairview would like to introduce two new additions to the team:

► **Mishone Donelson**

Mishone joined Fairview in November, 2008 as an Associate. Prior to joining Fairview, Mishone was Special Assistant to the CEO, and a Research Analyst at Ariel Investments where he was responsible for a variety of special projects and conducted research on equity securities. Mishone holds a B.S. in Chemical Engineering from MIT and an M.B.A in Finance and Accounting from the Kellogg School of Management where he was a Robert Toigo Fellow.

► **Alan Mattamana**

Alan Mattamana joined Fairview in January, 2009 as a Senior Associate. Prior to joining Fairview, Alan was a Principal at Polaris Venture Partners, where he focused on investment opportunities in medical technology as well as growth equity investments in the healthcare, technology, consumer, and business services industries. During his tenure with Polaris, Alan served as Board Observer to several life sciences portfolio companies including Advion BioSciences and GI Dynamics. Prior to Polaris, Alan was a Business Analyst with McKinsey & Co. Alan obtained a B.S. in Chemical Engineering from Princeton University with a minor in Engineering Management Systems and an MBA from Harvard Business School.

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As this trend continues, and platforms integrate to the point of widespread interconnectivity, the true efficiency of cloud computing will become more evident.

Growth oriented companies stand to benefit greatly from cloud computing because it changes the fundamental cost structure of most web startups and young pre-product companies with little to no revenue. Processing power, servers and storage are all accessible affordably and on-demand over the cloud. This is often referred to as Infrastructure as a Service (IaaS). The lower costs associated with cloud computing may also be vital in the current economic climate where many venture backed companies are looking to cut costs and reduce their "burn rate" to survive the downturn. Finally, the lower cost structure allows entrepreneurs to start companies they normally would not have been able to start in a capital-constrained environment.

Venture Capital's Role

Cloud computing is a powerful trend and, like other major technological trends, there is a role for venture capital in its development. The utility and infrastructure level, which has essentially been commoditized, will likely be dominated by bigger players such as Google, Amazon, Microsoft, IBM, Sun Microsystems, and Oracle, who have economies of scale in the cost of equipment and power that are not available to smaller players. As these larger players compete to gain a competitive advantage, they are expected to roll out more advanced application programming interfaces (APIs) and tools for application developers to layer onto the basic infrastructure services they provide. In many cases, they will acquire promising venture-backed startups that can add value by building such tools.

Moving down the chain in the cloud platform, there will also be opportunities for companies developing applications at the end-user level. Entrepreneurs will be able to develop products and write applications around the core infrastructure of the bigger play-

ers. Competitive advantages will be similar to those that developed with Web 2.0., particularly network effects. Network effects refer to the idea that users add value to an application by their use of it and that a user's data becomes more valuable if it is in the same place as other users' data. Start-ups developing applications and platforms that can harness network effects will be able to gain a competitive advantage among applications developed around cloud computing. Venture capital firms, armed with experience investing IT startups, should be able to identify the competitive advantages that will make the next wave of startups successful.

At Fairview, about half of our investments are in the IT sector. We have adequate exposure to companies that are at the forefront of cloud computing, particularly in the virtualization and software as a service space. Going forward, we expect more investments in this area as cloud computing becomes more mainstream and companies develop more products around the technology.

MARKET UPDATE

With the United States officially in a recession amidst a global economic slowdown, private equity, as with almost all other asset classes, is showing it is not immune.

Private equity fundraising, which had remained strong through the third quarter of 2008, experienced a significant slowdown in the fourth quarter. A total of 99 U.S. private equity funds raised just \$43 billion in the quarter, down significantly from the \$100 billion raised by 208 funds in the fourth quarter of 2007. For the year, 363 funds raised \$266 billion, 18% below the amount raised in 2007.

Buyout fundraising took the biggest hit, dropping 26% from 2007 levels. Venture capital fundraising, which was actually ahead of its 2007 pace at the end of the third quarter, experienced a sharp decline in the fourth quarter, resulting in an overall year-over-year decline of 25%. At the end of 2008, venture capital firms had raised \$25 billion across 150 funds, the lowest total for the industry since 2004. In total, 2008 still ended as the second-best year on record for private equity fundraising, buoyed by strong

fundraising totals from mezzanine and distressed funds. Nonetheless, the dramatic declines experienced in the fourth quarter may continue into 2009 as firms cut back on fund sizes and limited partners have less capital to commit.

As of the third quarter, venture capital investment activity had yet to be impacted by the turmoil in the global financial markets. Almost \$23 billion had been invested in venture deals, off only slightly from the amount invested through the same period a year ago. Venture investments, as usual, were led by information technology and healthcare deals but notable increases occurred in the clean technology sector, where in the fourth quarter, investment exceeded \$1 billion in a quarter for the second time. While year-end data was not available at the time of this publication, it is expected that overall venture investment will have declined in the fourth quarter relative to the same period in 2007.

A consequence of global financial turmoil has been a weak exit environment for private equity-backed companies. The environment has changed the venture investment lifecycle –

companies need to be sustained longer as they wait for exit and consequently, it is expected that less capital will be available for new investments. The year ended with just six venture-backed IPOs (none in the second and fourth quarters), the fewest since 1977. On the M&A side, there were just 260 venture-backed M&A transactions in 2008, the first year since 2003 when there were less than 300 transactions. As a result, the median time to exit for venture-backed companies has reached an all-time high – 6.5 years via M&A and 8.3 years via IPO.

Until exit avenues re-open, fundraising and new investment is expected to slow. Valuations are expected to dip, in part due to new fair value accounting standards. However, good companies with good business models will still be able to get funding as venture capitalists continue to invest, albeit more judiciously than in years past. New venture investment should continue in the clean technology sector, the less cyclical healthcare sector, and the ever-changing information technology sector, especially in areas with emerging opportunities like the mobile and cloud computing spaces.

Data Sources: Dow Jones PEA, ThomsonReuters, and the NVCA.