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Published: Friday, September 28, 2001

By DENNIS TAYLOR

A trio of top Silicon Valley financial minds warned last week that the Sept. 11 terrorist attacks have plummeted the technology sector into a recession.

Not by classical definitions -- two consecutive quarters of negative movement in the gross domestic product -- but that's only a matter of time. And not that the valley wasn't already dancing on the fringes of recession, but the uncertainty caused by the attacks has quickened the pace and likely will play a role in extending its duration, the experts said.

Accel Partners general partner Jim Breyer, Morgenthaler Ventures general partner Gary Morgenthaler and Goldman Sachs managing director Brad Koenig told a gathering of roughly 500 techies at a Churchill Club event last week that the outlook for technology was worrisome before the attacks. But now the real pain will begin.

"There's no question this tragedy is going to force the economy into recession," Koenig said. "It will be a much more immediate, deeper downturn."

The dour forecast is based on both economic analyses their respective firms have conducted as well as from conversations with executives from the myriad of technology companies with which they have relationships. The panel was sponsored by Red Herring Communications and the Nasdaq stock market.

Both Morgenthaler and Accel are top-tier venture capital firms that are highly respected in Silicon Valley, and Goldman Sachs is arguably the world's pre-eminent investment bank.

"[Chief information officers] are telling me they are just not going to free up funds for information technology spending until there's more visibility of where the market is going," said Accel's Breyer. "I believe 2002 will be a very difficult year, and I think [a recovery] will take a couple of years after that."

But before anyone runs out and calls The Hemlock Society, take heart: There are billions of dollars in untapped venture capital out there, still looking for the next new thing. And while it's true that VC investments have slowed remarkably, the VCs themselves insist that good technologies with strong management teams and clear visibility of their markets will still get funded.

An additional problem facing VCs is the volatility in the markets and its influence on valuations. Outside the Churchill forum, VCs have told Biz Ink that they are in a holding pattern trying to assess where valuations are going. They're concerned that if they set valuations today, and the markets slide further, or

remain stagnant, their liquidity will disappear.

For example, if a VC receives equity in a company valued at \$20 million today, but 24 months later it's worth \$18 million in the public markets, they'll have some explaining to do with their limited partners -- the pension funds, insurance companies, university endowments and other institutional investors that comprise the lion's share of VC funds.

But, VCs still have to get up in the morning and go to work, and their work is funding promising startups, tremendously important in Silicon Valley. Historically, the Bay Area nets roughly 30 percent of all venture investments in the United States. The venture industry has been pumping more than \$3 billion per quarter into the Bay Area economy over the past five years, according to the National Venture Capital Association.

"So what is the next big thing?" asked Tony Perkins, who along with brother Michael moderated the panel discussion at Hyatt Ricketts in Palo Alto. The Perkins brothers are the founders of Red Herring magazine and the authors of "The Internet Bubble," as well as the newly released "The Internet Bubble, The Inside Story on Why it Burst."

Morgenthaler is likely to place his bets on the still-growing demand for broadband delivery, while Breyer believes the challenge companies will face in the next two to three years will place more emphasis on products that will trim costs and can be applied directly to a return on investment.

Naturally, the ability of the terrorists to commandeer four commercial aircraft, as well as the panel's take on emerging technologies, prompted questions relating to the role technology will play in security.

Morgenthaler reiterated that there are large sums of capital available, and that "entrepreneurs haven't gone away," which would tend to set the stage for the emergence of products such as anti-viral software, air travel security, biometrics and videoconferencing devices.

But Breyer takes took a more sober view of the recent events, reminding everyone that the attack was decidedly low-tech.

"It was about human error," he said. "There are very few lessons I would be able to apply to my day job [of technology]. What happened was much more profound than simply technology."

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Letter to Editor

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