

Entrepreneurial Confidence Index (ECI)

Second Quarter 2004
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Kenneth McCarthy, Chief Economist

kjmccarthy@vfinance.com

Tel. (212) 508 4738

Victoria Santaella, Exec. VP, Institutional Services

vsantaella@vfinance.com

Tel. (212) 508 4737

Executive Summary

Entrepreneurial confidence soared in the second quarter led by strong interest increases in the software, diversified services and electronics industries. At a level of 207.1 (2002=100), the Entrepreneurial Confidence Index (ECI) rose 13.1% versus the previous quarter and stood a full 32.6% above the level of a year ago. Since reaching a bottom two years ago, the ECI has increased 145.0%.

The increase in the ECI over the past two years indicates that the interest, desire and confidence of entrepreneurs are at the highest levels of the past three years. However, historical data suggests that new business creations have not matched the growing interest evident in the rise of the ECI. According to the Labor Department, the number of newly opened establishments adding employees in the third quarter of 2003 (latest available data) fell to its lowest level since the fourth quarter of 1998. Venture capital (VC) investments in the first quarter of 2004 (latest available data) fell to the lowest level since the third quarter of 1996, suggesting that the liquidity problem in the venture community still persists.

However, the first sign of a potential solution to this liquidity problem was the fact that the number of initial public offerings (IPOs) in second quarter 2004 reached its highest level since the third quarter of 2000. This trend needs to continue in order to effectively trigger a reactivation of VC funding and the creation of new businesses and jobs.



The entrepreneurs are ready but they need the support of the investment community to influence the economy and generate the long awaited jobs and innovative new industries needed to maintain a competitive US economy.

Other important findings from the second quarter survey include:

- Technology related sectors accounted for 21.2% of all entrepreneurial interest in the second quarter. Major areas of interest in technology include **Internet Software and Services, IT Consulting, Electronic Equipment and Games Software**. In addition, **Real Estate** remained as one of the hottest sectors for entrepreneurs.
- **Media** was the fastest growing sector attracting 7.2% of all entrepreneurs in the second quarter up from 6.5% in the first quarter and 6.1% in the third quarter of 2003. Within this sector, **Music Production and Publishing** was surprisingly strong. This sub-sector ranked first in terms of growth and third in terms of entrepreneurial interest.
- Sectors that were ranked low in our index or that are experiencing a decline in entrepreneurial interest included **Food, Consumer Non-durable Goods** and **Materials & Construction**. Concerns related to inflation, the war, higher oil prices and rising interest rates are clearly starting to affect consumer related industries.

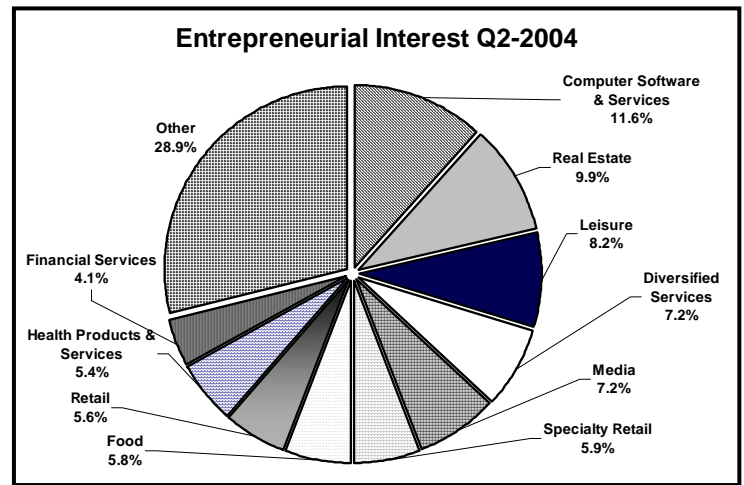
Following is a summary of the sectors and sub-sectors that experienced the largest changes in growth and interest.

| Q2/2004 | Rising | Declining |
|--------------------|---|---|
| Sectors | <ul style="list-style-type: none"> • Electronics • Media • Drugs | <ul style="list-style-type: none"> • Nondurable Consumer Goods • Materials & Construction • Food |
| Sub-Sectors | <ul style="list-style-type: none"> • Restaurants • Integrated Circuits • Travel Agencies | <ul style="list-style-type: none"> • Diversified Foods • Aerospace • Sports Teams |

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Response Shares

In the second quarter of 2004, the industry sector receiving the greatest interest was **Computer Software and Services**, which accounted for 11.6% of all responses. This was unchanged from the share this sector received in the first quarter. Within this sector, the sub-sectors generating the most interest were **Internet and Intranet Software and Services** and **Information Technology Consulting Services**. The second major industry sector was **Real Estate**, which accounted for 9.9% of all responses. Within Real Estate, the sub-sectors showing the greatest interest were **Real Estate Development** and **Property Investment and Management**. **Leisure** ranked third among the major industry sectors with 8.2% of all responses led by **Restaurants**. Moreover, the **Retail** industry sector continues to generate strong interest. Taken together, **Retail** and **Specialty Retail** accounted for 11.5% of all responses. The sectors with the lowest entrepreneur interest continue to be **Conglomerates**, **Chemicals** and **Metals & Mining**. Aggregately, these three sectors accounted for only 1.6% of all responses.

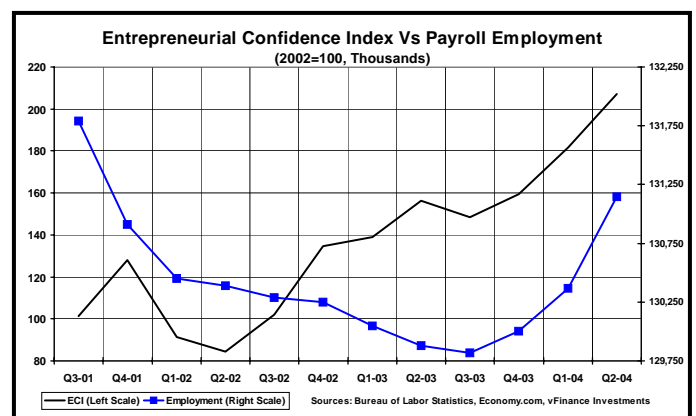


Specific industry sub-sectors with the largest share of interest were **Miscellaneous Retail (3.13%)**, **Property Investment & Management (2.80%)**, **Music Production and Publishing (2.73%)**, **Real Estate Development (2.61%)**, **Internet & Intranet Software & Services (2.32%)** and **Miscellaneous Entertainment (2.15%)**. These six sub-sectors accounted for 15.7% of all responses in our survey.

The ECI and The Economy

Analysis of the relationship between the ECI and the general economy indicates that this surge in entrepreneurial confidence reflects the strong increase in employment that began in the first quarter of 2004. When employment increases, confidence in the economy rises. Confident entrepreneurs are more willing to take the risk of starting a new business secure in the knowledge that if they fail they will be able to find employment. Thus, the climb in the ECI in the second quarter reflects the acceleration of employment growth seen in the first and second quarters.

To the extent that this increase in interest is turned into actual new businesses, this process should become self-reinforcing. The new businesses that are created will hire more employees helping to generate healthy employment growth that will create an environment in which more potential entrepreneurs feel confident enough to strike out on their own.

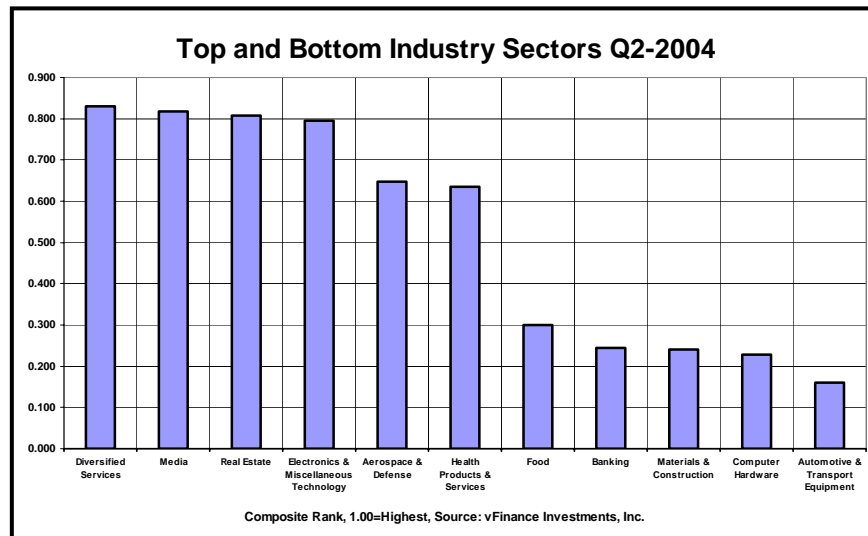


The key to this process will be the access to capital. We have seen over the past year that when capital is not available to entrepreneurs, which for a variety of reasons appeared to be the case in 2003 and early 2004, it constrains the entrepreneurial activity. We have recently seen some signs of improvement in the financial markets that suggest more capital may have become available this year. It will be some time before we are able to draw any definitive conclusions about whether increased financing sources has caused increased business formations, but conditions for this appear to be better than we have seen in several years. Without this capital, innovation will slow and the economy will suffer.

Major Industry Sectors

vFinance ranks the 28 major industry sectors, based on size and growth. The rankings are from a low of 0.00 to a high of 1.00. A highly ranked industry sector shows a combination of a high level of interest and rapid growth in interest. This composite ranking provides an insight into where entrepreneurs are focusing their efforts and can provide investors and policy makers with valuable information on prospective future economic and market trends.

In the second quarter, the highest ranked major industry sector was **Diversified Services** (0.830), followed by **Media**



(0.817), **Real Estate** (0.808) and **Electronics and Miscellaneous Technology** (0.795). Sectors that showed significant increase in their ranking, indicating a healthy increase in entrepreneurial interest included **Telecommunications** (0.554) and **Aerospace and Defense** (0.647). These improvements indicate that the telecommunications sector has begun to revive after consistently weak results since our survey began in 2001. Furthermore, we noted strong interest in providing goods and services for the defense sector in response to the ongoing war in Iraq and the war on terror.

- ✓ The **Diversified Services** sector saw an increase in its ranking largely because of a healthy growth in interest in starting businesses which will demand services. The two highest ranked sub-sectors within this sector were **Staffing** and **Outsourcing and Other Human Resources**. Other sub-sector showing strong increases in interest included **Management Consulting** and **Miscellaneous Business Services**. These two categories probably reflect layoffs as workers who are let go and become consultants of their former employers.
- ✓ The second highest ranked sector was **Media**. This sector showed a remarkable surge from the first quarter, when it was one of the lower ranked major industry sectors. The main reason for this turnaround was a sharp increase in interest in the **Music Production and Publishing** sub-sector, which went from being one of the lowest ranked sub-sectors a year ago to being among the highest ranked today. In addition, there was a solid increase in interest in **Television Production** and **Programming and Distribution**.
- ✓ **Real Estate** remains a favorite sector among entrepreneurs seeking to take advantage of booming housing market. As sales of new and existing homes reached record levels in the second quarter, the interest in managing property and developing real estate remained very high. In fact, three of the top eight ranked industry sub-sectors were in the **Real Estate: Property Investment and Management, Real Estate Development and Residential Real Estate Investment Trusts**. The strength of the interest in this sector may well be a sign of an impending peak in the residential real estate market. As more and more entrepreneurs and investors seek to jump into this market, there is a strong likelihood that it will become saturated with providers just as the increase in interest rates constrains demand.

- ✓ The **Electronics and Miscellaneous Technology** sector recorded a sharp increase in its ranking from the level of the preceding quarter. Of the 13 sub-sectors in this major sector, 10 recorded increased entrepreneurial interest. The largest interest increase was in the **Miscellaneous Electronics** sub-sector, which went from a middle ranked sub-sector to the ninth ranked out of 289. Other sub-sectors that showed healthy improvement were **Semiconductor-Integrated Circuits** and **Diversified Electronics**.
- ✓ The **Aerospace and Defense** sector showed strong growth largely because of a sharp increase in **Aerospace-Defense Products**. This sub-sector saw a sharp increase in interest during the quarter, which boosted it to the sixth ranking out of 289. This may reflect a desire to meet the needs of the military in the war on Iraq and the war on terror.

The lowest ranked major industry sectors were a mixed bag, from **Autos and Transportation Equipment** (0.161) to **Computer Hardware** (0.228), **Materials & Construction** (0.241) and **Banking** (0.246). In general, these sectors do not generate a high level of entrepreneurial interest and in the second quarter that already low level of entrepreneurial interest declined even further. The **Banking** sector for example accounted for 1.0% of all inquiries while **Computer Hardware** represented a mere 1.4% of the inquiries. This suggests that entrepreneurs no longer look at the hardware side of the computer industry as an opportunity. Software, by comparison, had the largest number of entrepreneur respondents.

Because our ranking system relies heavily on the growth (or decline) in interest in the industry sectors, those that see a sharp increase in interest can quickly rise to the top of the rankings. The result is a tendency for the rankings to change significantly from one quarter to the next. For example, **Materials and Construction** was highly ranked in the first quarter but fell to one of the lowest rankings in the second quarter when interest in several sub-sectors from **Contracting** to **Heavy Construction** all declined.

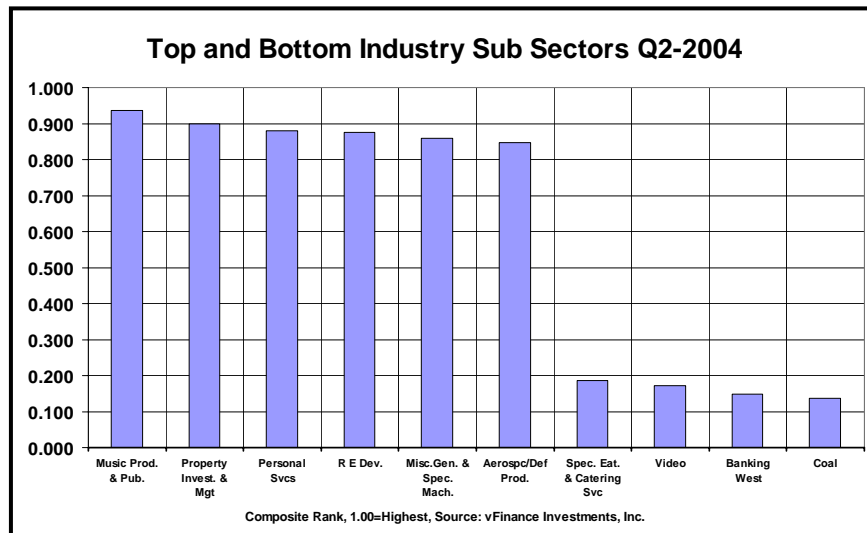
The following table shows the top ten major industry sectors for each of the past three quarters.

| Major Industry Sector | Q4-03 | Major Industry Sector | Q1-04 | Major Industry Sector | Q2-04 |
|----------------------------------|--------|---------------------------------|--------|--------------------------------|--------|
| Automotive & Transport Equipment | 0.7054 | Real Estate | 0.9330 | Diversified Services | 0.8304 |
| Materials & Construction | 0.6920 | Consumer Products - Non-Durable | 0.8036 | Media | 0.8170 |
| Consumer Products - Non-Durables | 0.6696 | Diversified Svcs | 0.8036 | Real Estate | 0.8080 |
| Retail | 0.6696 | Food | 0.7723 | Electronics & Misc. Technology | 0.7946 |
| Real Estate | 0.6607 | Retail | 0.7143 | Aerospace & Defense | 0.6473 |
| Financial Services | 0.6429 | Materials & Construction | 0.7098 | Health Products & Services | 0.6339 |
| Specialty Retail | 0.6250 | Financial Services | 0.6071 | Manufacturing | 0.5938 |
| Food | 0.6116 | Leisure | 0.6027 | Drugs | 0.5536 |
| Transportation | 0.5804 | Computer Software & Services | 0.5893 | Telecommunications | 0.5536 |
| Banking | 0.5491 | Health Products & Services | 0.5848 | Retail | 0.5491 |

- ✓ The **Real Estate** sector has consistently been one of the highest ranked sectors over the past three quarters probably due to the housing boom. The only other sector that has been in the top 10 for each of the past three quarter is **Retail** but it appears that interest in this sector is fading as it has dropped from fourth to tenth since the end of 2003.
- ✓ One sector on the rise is **Health Products and Services**, which was the sixth ranked sector in the second quarter, up from tenth in the first quarter. Within this sector, **Home Health Care** and **Medical Practice Management & Services** showed particularly strong increases in interest.
- ✓ Sectors experiencing a decline in entrepreneurial interest include **Automotive and Transportation Equipment**, **Banking** and **Computer Hardware**.

Industry Sub-Sectors

Of the 289 industry sub-sectors tracked by vFinance, 183 saw the number of entrepreneurs expressing interest increase and 91 saw declining interest in the second quarter compared to the first quarter. This was a slight decline from the first quarter when 207 sub-sectors experienced increases in interest. Nevertheless, this was the second highest number of sub-sectors showing increases since the survey was initiated in the third quarter of 2001.



- ✓ The **Real Estate** sector continued to dominate the performance of the sub-sectors with three in the top eight including **Real Estate Development** and **Property Investment and Management**. These two sub-sectors were also in the top five highest ranked in terms of the total number of responses. It appears likely that entrepreneurs continue to view the housing sector, one of the hottest sectors of the economy today, as an opportunity.
- ✓ The biggest surprise among the sub-sectors was the surge to the top of our index by the **Music Production and Publishing** group. In the third quarter of 2003 this sector was ranked 237. It rose to 25 by the first quarter and to the top spot in the second quarter. It accounted for 2.7% of all responses, making it the third ranked sub-sector in terms of number of responses.
- ✓ Another surprising ranking was the **Miscellaneous General and Special Machinery**, which came in as the fifth highest-ranking sub-sector. This sector showed substantial growth in interest during the past two quarters. This increase may reflect the revival of the manufacturing sector, in general, and machinery in particular. During the past year, orders for machinery have increased 20%. This represents the strongest growth in a decade. As manufacturing production has surpassed its pre-recession peak, and continues to climb, the need to increase efficiency to compete with low labor cost countries may be prompting an increase in interest in applying technology to the machinery sector.
- ✓ Although not in our top ten, there were two telecommunications sub-sectors that generated significant interest: **Communications Processing Equipment** and **Miscellaneous End-User Communications Services**. The increased interest in these sub-sectors as well as higher interest in **Switching and Transmission Equipment** helped to push **Telecommunications** into the top 10 for the first time since we began this survey in 2001

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The low ranked sub-sectors were **Coal**, **Banking-West**, and **Video Retail**. While the **Coal** sector is something of a surprise since higher oil prices make this fuel attractive, the low ranking of **Video Retail** is no surprise with digital cable, digital video recorders (i.e. Tivo™) and video on demand eroding that market.

The movement in rankings from one quarter to the next is shown in the following table. Because of the large number of sub-sectors, there tends to be significant movement between quarters.

| Major Sector | Sub-Sector | Q4-03 | Major Sector | Sub-Sector | Q1-04 | Major Sector | Sub-Sector | Q2-04 |
|----------------------------------|---|--------|---------------------------------------|-----------------------------------|--------|--|----------------------------------|--------|
| Real Estate | Miscellaneous Real Estate Services | 0.9650 | Leisure | Sporting Activities | 0.9338 | Media | Music Prod. & Pub. | 0.9360 |
| Transportation | Trucking | 0.9299 | Consumer Products - Non-Durables (ND) | Miscellaneous ND Consumer Goods | 0.9299 | Real Estate | Property Investment & Management | 0.8988 |
| Automotive & Transport Equipment | Auto Parts | 0.9234 | Real Estate | Real Estate Development | 0.9299 | Diversified Services | Personal Services | 0.8789 |
| Materials & Construction | Miscellaneous Building Materials | 0.9079 | Real Estate | Property Investment & Mgmt. | 0.9226 | Real Estate | Real Estate Development | 0.8750 |
| Consumer Products – Durables | House wares & Accessories | 0.9074 | Automotive & Transport Equipment | Buses & Other Vehicles | 0.9001 | Manufacturing | Misc. Gen. & Spec. Mach. | 0.8581 |
| Leisure | Restaurants | 0.8841 | Diversified Services | Personal Services | 0.8936 | Aerospace & Defense | Aerospace/Def Prod. | 0.8482 |
| Aerospace & Defense | Maintenance & Service | 0.8819 | Food | Diversified Foods - Other | 0.8932 | Diversified Services | Staffing | 0.8248 |
| Leisure | Tour Operators & Other Travel Services | 0.8776 | Diversified Services | Consumer Services | 0.8919 | Real Estate | REIT - Residential | 0.8131 |
| Specialty Retail | Sporting Goods Retailing | 0.8694 | Specialty Retail | Toy & Hobby Retailing & Wholesale | 0.8867 | Electronics & Miscellaneous Technology | Miscellaneous Electronics | 0.8101 |
| Automotive & Transport Equipment | Motorcycles & Other Small-Engine Vehicles | 0.8534 | Real Estate | Residential Construction | 0.8737 | Leisure | Restaurants | 0.8075 |

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Boca Raton, FL
3010 North Military Trail, Suite 300
Boca Raton, FL 33431
Tel. 800 266 8023

New York, NY
880 Third Avenue, 4th Floor
New York, NY 10022
Tel. 800 564 0859

vFinance Investments Main Branch Offices

Atlanta, GA
Tel. 404 239 6080

Blairstown, NJ
Tel. 908 362 8055

Broomall, PA
Tel. 610 356 6988

Boca Raton, FL
Tel. 561 955 8555

Boca Raton, FL
Tel. 561 756 4235

Clearwater, FL
Tel. 727 724 1941

Dallas, TX
Tel. 214 459 8322

Dover, DE
Tel. 302 734 0314

Durham, NC
Tel. 919 489 5896

Flemington, NJ
Tel. 908 782 0868

Florham Park, NJ
Tel. 973 966 0101

Houston, TX
Tel. 281 416 3000

Houston, TX
Tel. 281 759 3300

Lake Grove, NY
Tel. 631 738-1808

Melville, NY
Tel. 800 403 6722

Mount Laurel, NJ
Tel. 856 914 9806

Newark, DE
Tel. 302 836 6005

Newport Beach, CA
Tel. 949 723 1167

Newton, PA
Tel. 215 579 4547

Philadelphia, PA (Logan Capital)
Tel. 800 215 1100

Pittsford, NY
Tel. 585 385 2700

Pleasanton, CA
Tel. 925 398 0848

Redbank, NJ
Tel. 732 450 8100

Shrewsbury, NJ
Tel. 888 900 8087

Topeka, KS
Tel. 785 272 1323

Warrendale, PA
Tel. 724 933 7100

Westport, CT
Tel. 888 766 9856

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