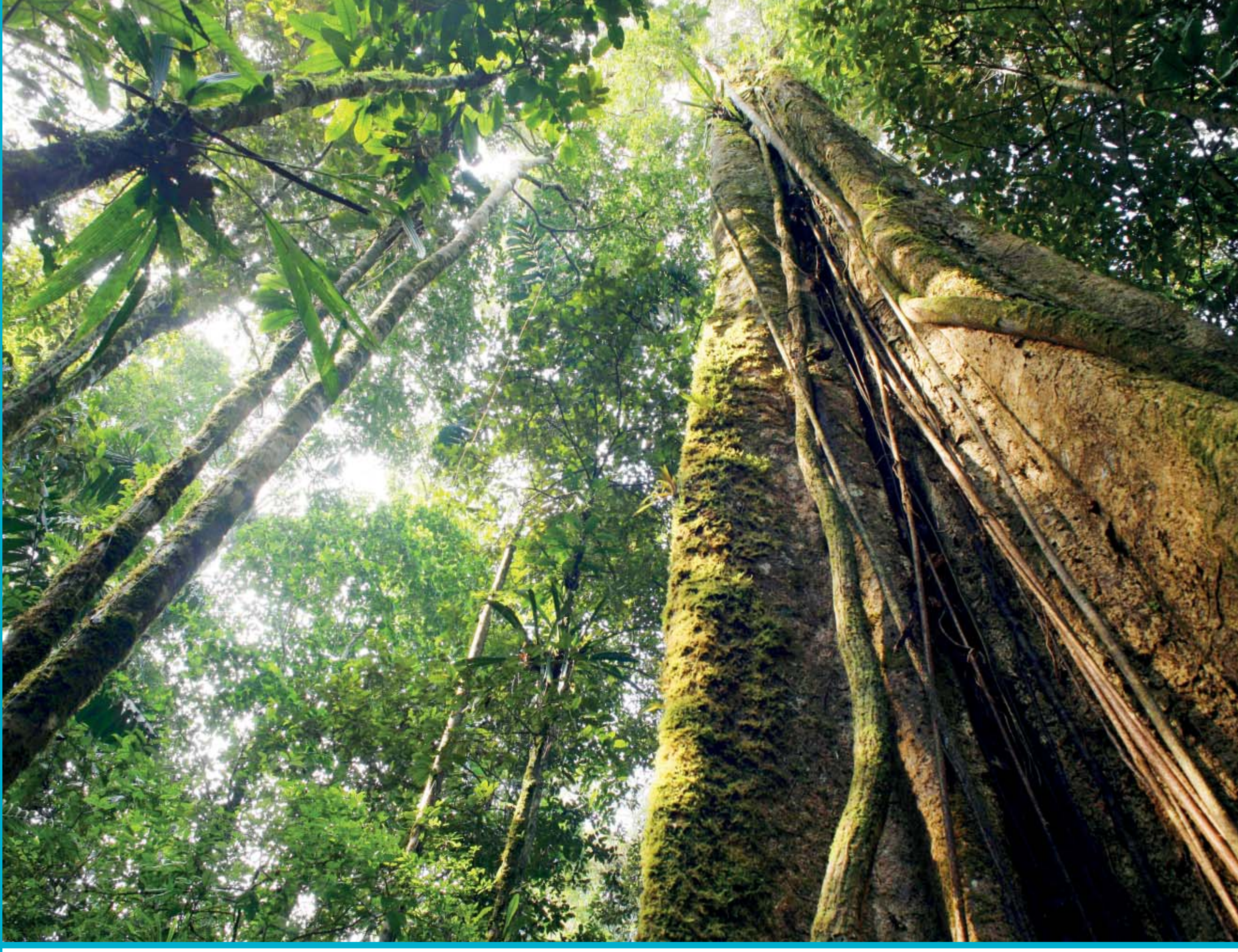


PREQIN SPECIAL REPORT: VENTURE CAPITAL FUND MANAGER OUTLOOK

H2 2017

alternative assets. intelligent data.

FOREWORD

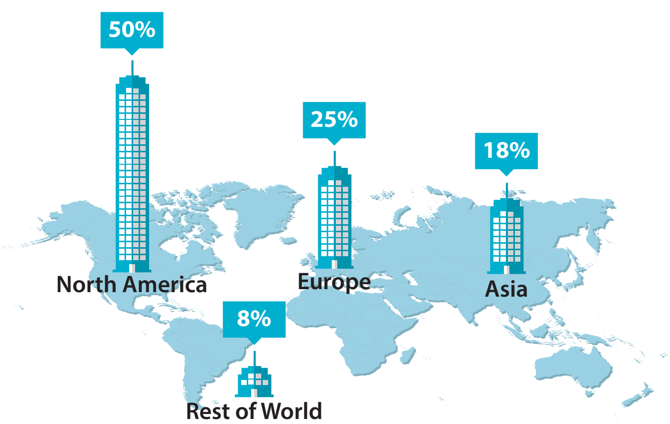
Recognizable as a unique strategy in its own right within the private equity asset class, this year Preqin puts venture capital into focus for the H2 2017 Fund Manager Outlook. As the sector with the largest share of private equity fund managers (standing at 65% in 2017), the characteristics which make up venture capital investing have set the strategy apart from buyout, growth equity and other foundational categories of private equity.

However, managers are still concerned with the current exit environment, deal pricing/valuations and fundraising. Valuations are certainly a concern in all areas of alternative assets, with public markets at or near all-time highs across the developed world. Competition for fundraising is likely to remain contested, as investors are taking more research and due diligence in house with allocations to alternatives on the rise.

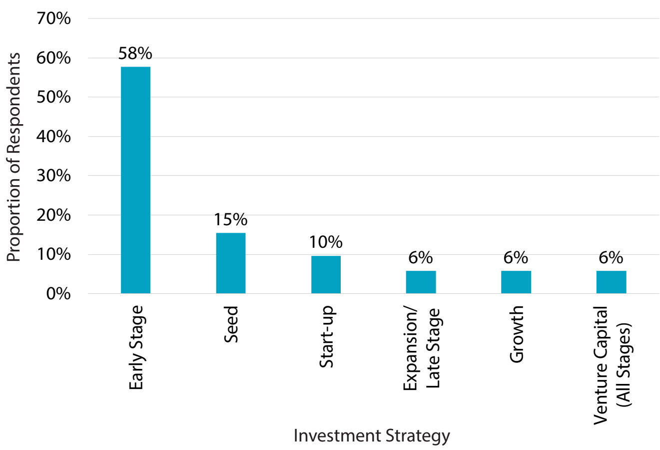
Among venture capital managers surveyed for this report, half are headquartered in North America, 25% in Europe and 18% in Asia, with the remainder located in Australia, Latin America and the Middle East. Early stage is the most prevalent primary strategy among respondents (58%), followed by seed (15%) and start-up (10%). More than 61% of respondents manage less than $100mn in assets, while 4% manage more than $1bn.

We hope you find this report useful, and welcome any feedback you may have. For more information, please visit www.preqin.com or contact info@preqin.com.

Survey Respondents by Headquarters Location



Survey Respondents by Primary Venture Capital Investment Strategy



DEAL FLOW AND COMPETITION

Key challenges identified by Venture Cap managers for the coming years include the exit environment, performance and deal pricing. Lofty valuations and an influx of LPs to the space have been a boon to fundraising, putting pressure on managers to keep the pace of deal flow, and most importantly, produce the high absolute returns that are the hallmark of successful venture capital GPs.

Established managers are also feeling pressure due to increased competition for deals from new GP entrants, the larger pool of available capital and a need to deploy capital in the marketplace; it is unsurprising that 32% of GPs reported that pricing for portfolio companies is higher than one year ago.

FUND MANAGER VIEWS ON PORTFOLIO COMPANY PRICING COMPARED TO 12 MONTHS AGO

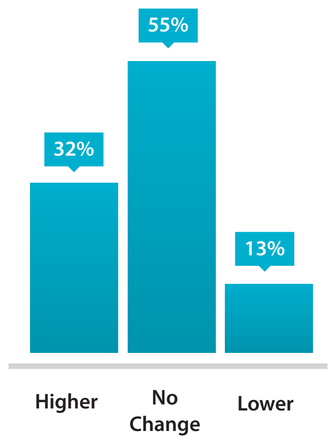
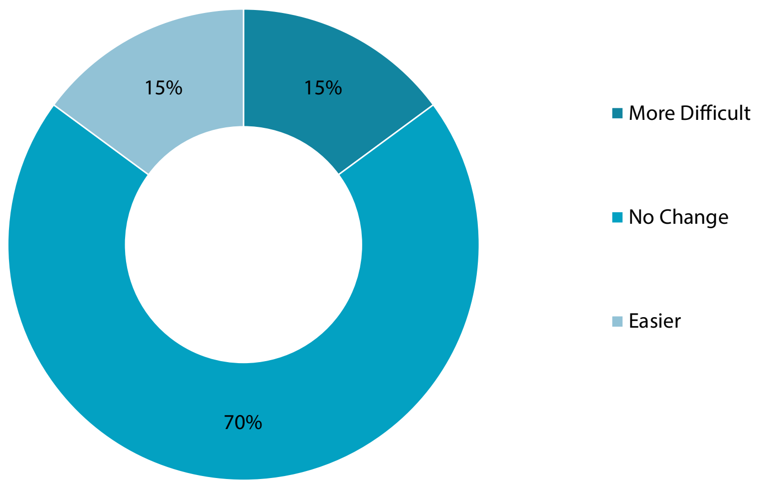
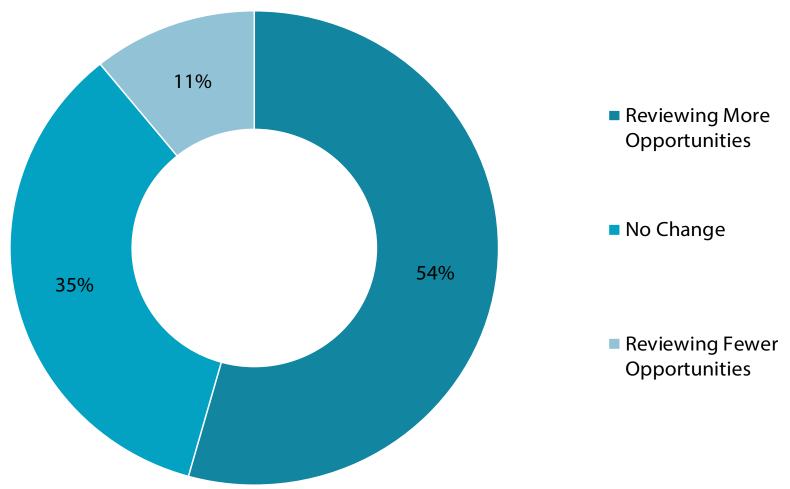


Fig. 1: Fund Manager Views on the Difficulty of Finding Attractive Investment Opportunities Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, June 2017

Fig. 2: Amount of Investment Opportunities under Review by Fund Managers Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, June 2017

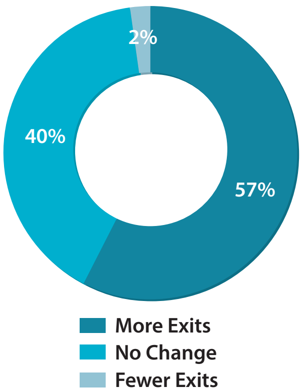
Furthermore, GPs are more likely to agree to higher valuations for portfolio companies in order to simply secure a deal, as a result of the crowded environment. Competition among managers, cheap financing and a global increase in venture capital fundraising are just a few of the reasons why valuations and deal pricing have increased steadily in the recent past. Deal prices are undoubtedly increasing, but the number of attractive investment opportunities has remained constant for the majority of fund managers; over 70% reported no change in their ability to source promising investment opportunities. However, over half of GPs are reviewing more opportunities now than 12 months ago. This uptick in activity is expected to continue, as the reach of venture capital investing continues to expand and developed platforms are brought into play across the spectrum, from seed to late stage investing.

Fund managers are confident that the exit environment, which has shown promising signs of picking up over the past three quarters, will continue to gain momentum through to the end of 2017. The majority (57%) of respondents believe that there will be an increase in exit activity over the next year, while another 41% predict it will remain the same. An increase in exit activity would do much to satisfy the concerns of both GPs and LPs across the alternatives space, particularly in venture capital.

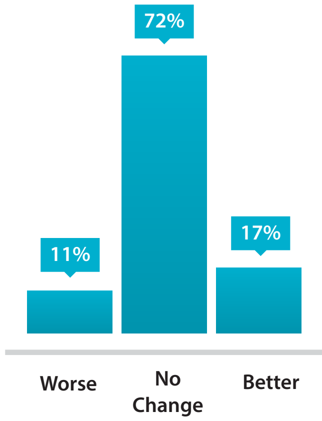
The largest proportion (49%) of GPs have seen an increase in competition for venture capital assets over the last year, with just 4% experiencing less competition (Fig. 3). The most competitive marketplace for venture capital remains the US, with the majority of managers and activity based on the West Coast.

Fund managers were also asked about the level of competition within each distinct venture capital strategy, as shown in Fig. 4. The largest proportion (47%) of GPs saw an increase in competition for early stage investments. The strategy also had the largest proportion of GPs citing less competition than 12 months ago, showing that experiences can differ greatly between regions, geography and market timing. Over half (52%) of fund managers are facing the same level of competition for transactions at the expansion stage, and a further 41% have seen more of competition.

AMOUNT OF INVESTMENTS FUND MANAGERS EXPECT TO EXIT IN THE NEXT 12 MONTHS COMPARED TO THE PAST 12 MONTHS

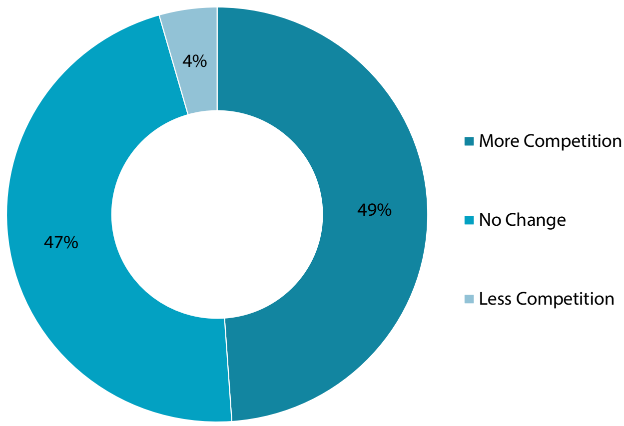


FUND MANAGER VIEWS ON HOW DEBT FINANCING TERMS FOR ACQUIRERS HAVE CHANGED OVER THE PAST 12 MONTHS



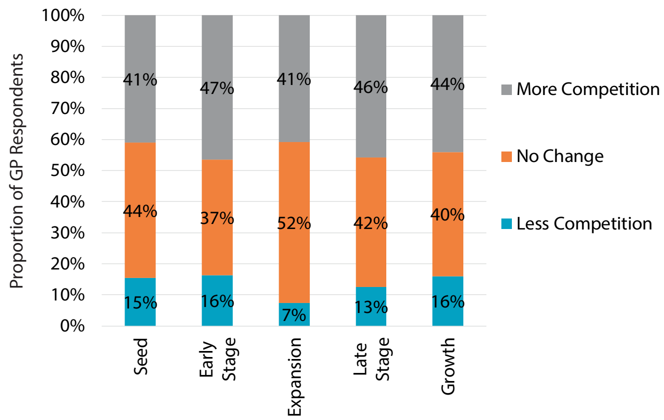
The majority (72%) of fund managers have seen no change in the terms for debt financing of venture capital investments as an acquirer over the past 12 months, while 17% reported receiving better terms. The cost of debt has played a strong part in the proliferation of alternative investing in a low interest rate environment in recent years. It has yet to be proven how imminent increases in interest rates would affect levels of venture capital activity, but for now, both investors and managers would generally be satisfied continuing the momentum seen so far in 2017.

Fig. 3: Fund Manager Views on the Level of Competition for Transactions Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, June 2017

Fig. 4: Fund Manager Views on the Level of Competition for Transactions Compared to 12 Months Ago by Investment Type



Source: Preqin Fund Manager Survey, June 2017

FUND MANAGER VIEWS ON INVESTOR APPETITE

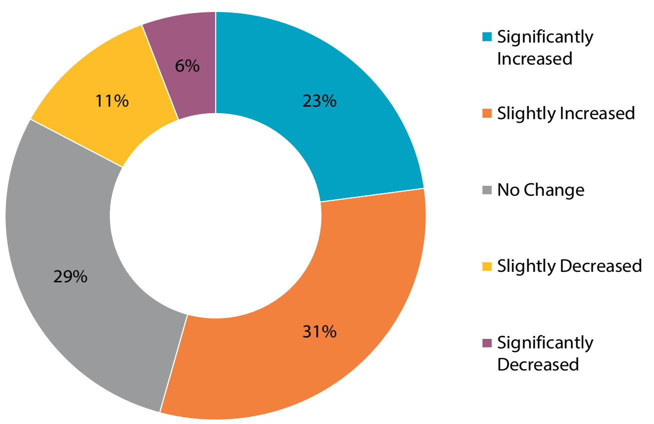
As at the end of H1 2017, fund managers have generally reported a favourable fundraising environment over the past 12 months. Just 17% have seen a decrease in investor appetite for venture capital, with the majority (54%) of GPs experiencing an increase in investor appetite (Fig. 5).

The majority of venture capital managers have seen increased appetite from family offices, as reported by 59% of respondents (Fig. 6). Large proportions of fund managers also noticed increased appetite from government agencies (37%), sovereign wealth funds (32%), fund of funds managers (29%) and private sector pension funds (26%). The largest share of fund managers cited a decrease in appetite for venture capital from banks, with 26% of respondents experiencing a decline in demand from the investor type.

Over half (51%) of fund managers reported an increase in appetite from Asia-based investors, while 9% felt their interest had decreased (Fig. 7). Considerable proportions of fund managers felt that demand for venture capital had increased from investors based in Europe (32%), Australasia (27%) and MENA (27%). In contrast, the majority (73%) of fund managers have seen no change in the level of interest from North America-based investors, with just 18% having seen an increase in appetite.

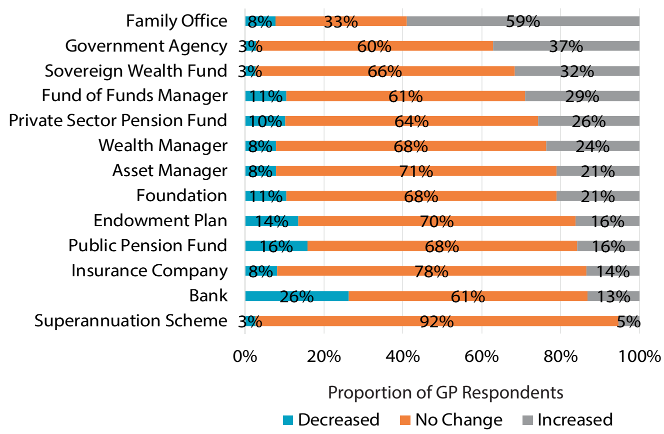
With over 1,500 venture capital funds in market, competition for investor capital remains high: 86% of fund managers reported an increase in competition over the past 12 months (Fig. 8). The ongoing fight for investor commitments among venture capital fund managers will likely only increase, as just 29% of investors surveyed by Preqin expect to increase their allocation to the strategy over the longer term, which will, in turn, slow the growth of available investor capital.

Fig. 5: Fund Manager Views on How Institutional Investor Appetite for Venture Capital Has Changed over the Past 12 Months



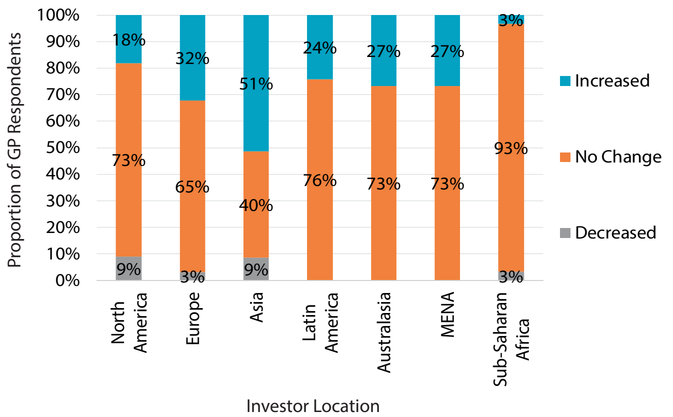
Source: Preqin Fund Manager Survey, June 2017

Fig. 6: Fund Manager Views on How Institutional Investor Appetite for Venture Capital Has Changed over the Past 12 Months by Investor Type



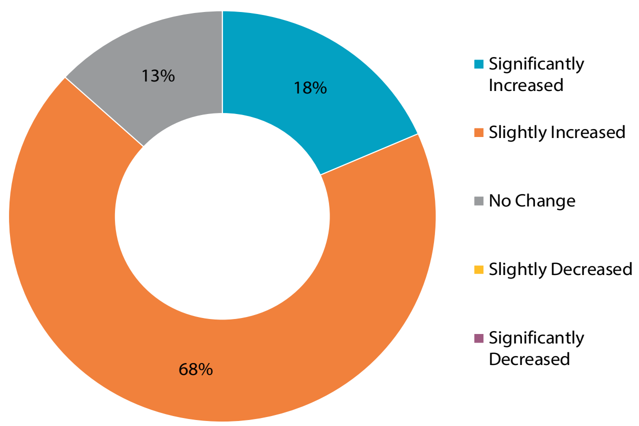
Source: Preqin Fund Manager Survey, June 2017

Fig. 7: Fund Manager Views on How Institutional Investor Appetite for Venture Capital Has Changed over the Past 12 Months by Investor Location



Source: Preqin Fund Manager Survey, June 2017

Fig. 8: Fund Manager Views on the Level of Competition for Institutional Investor Capital Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, June 2017

OUTLOOK AND FUTURE PLANS

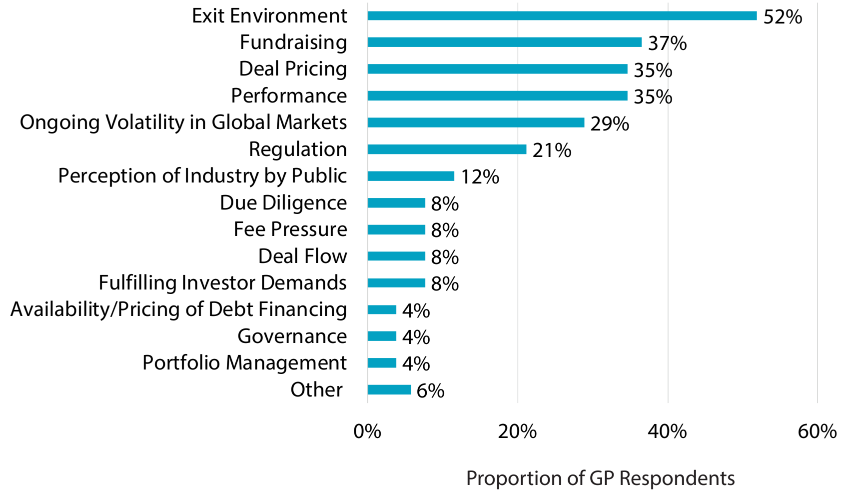
The exit environment, fundraising, performance and deal pricing stand out as the key issues affecting the venture capital industry in the minds of fund managers (Fig. 9). Generally, managers seem somewhat optimistic, with the exit environment being the only issue that was identified by more than half of GPs surveyed; and nearly 60% believe that the exit environment will improve over the next 12 months (page 4).

With the majority of GPs expressing no concern over their ability to source promising investment opportunities, it is no surprise that 65% of fund managers expect to deploy more capital in the next 12 months than in the previous year, including 44% that expect to commit significantly more (Fig. 10). Managers' confidence in the asset class informs on their reactions to market conditions, as the vast majority (86%) of fund managers in the process of launching funds have not altered their targeted returns based on current market conditions. This is also true for strategies and geographies targeted, with 83% of GPs stating that increased competition will not affect plans in these areas.

Over the next 12 months, a third of fund managers plan to offer more co-investment opportunities to limited partners in their funds; 14% will offer more joint ventures, while 8% expect to decrease the amount of separate accounts offered (Fig. 11).

When asked about the expected timing of their next venture capital fund launch, 44% of fund managers stated that as at Q2 2017 it was already in market. A further 15% expect a launch in the second half of 2017, followed by 20% that will launch funds throughout 2018.

Fig. 9: Fund Manager Views on the Biggest Challenges Facing the Venture Capital Industry in the Next 12 Months



Source: Preqin Fund Manager Survey, June 2017

TIMEFRAME WITH WHICH FUND MANAGERS INTEND TO LAUNCH THEIR NEXT VENTURE CAPITAL FUND

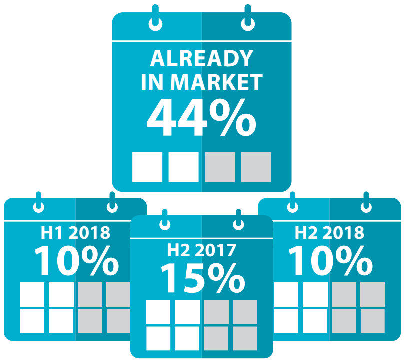
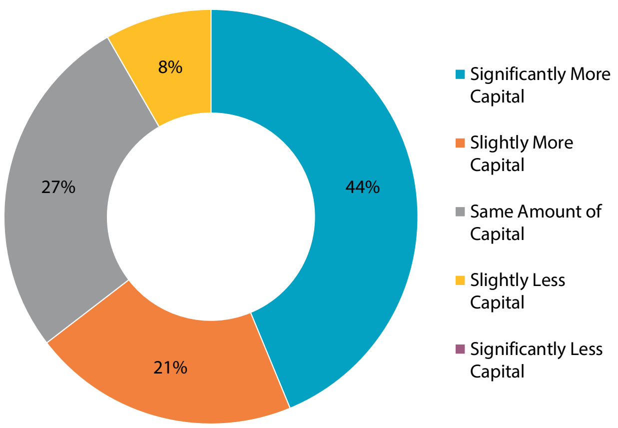
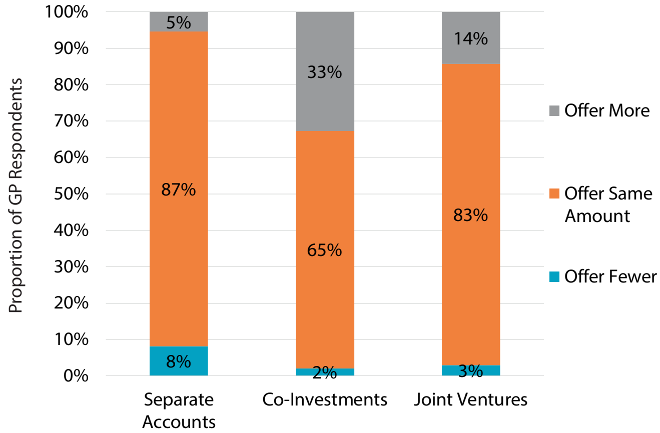


Fig. 10: Amount of Capital Fund Managers Expect to Deploy in the Next 12 Months Compared to the Past 12 Months



Source: Preqin Fund Manager Survey, June 2017

Fig. 11: Fund Managers' Plans to Offer Alternative Structures to Investors in the Next 12 Months Compared to the Past 12 Months



Source: Preqin Fund Manager Survey, June 2017

IN FOCUS: SERVICE PROVIDERS

Fund managers throughout the alternatives industry rely on service providers for a wide range of tasks. In many cases outsourcing these tasks makes the most sense based on the in-house capabilities and size of a given firm. As various support areas become more commonly outsourced, competition arises among service providers looking to secure business from fund managers seeking external resources for certain functions, such as fund administration, valuation and fundraising.

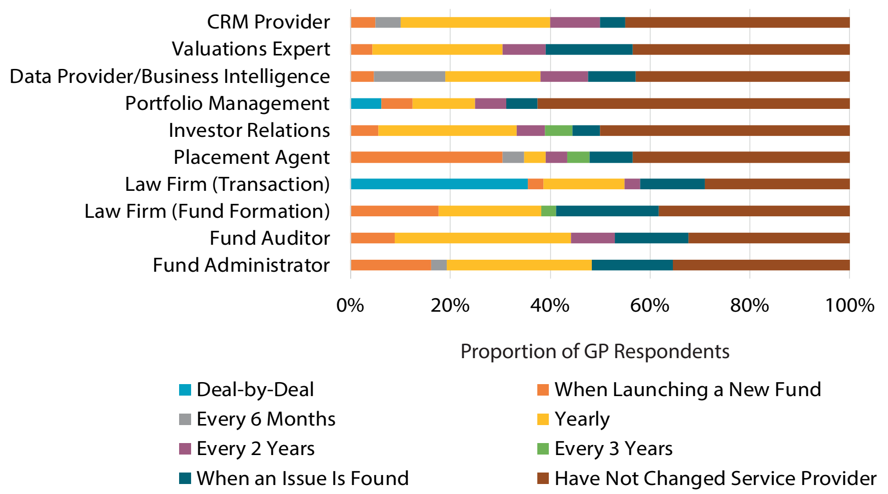
Survey respondents changed service providers in a wide range of business areas in 2016, as fund administrators, auditors, placement agents, portfolio managers, data providers, valuations experts and CRM providers were all tagged as having seen a transition throughout the year; law firms used in fund formation had the highest turnover (20%).

However, the reasoning behind the changes is as diverse as the types of operations provided: cost was the most common factor in the decision to change transactional law firms, while increased portfolio complexity was the most cited reason for a change in CRM provider. Certainly, cost and quality of service are at the forefront of most business decisions for managers choosing an external provider, along with many other factors that can impact the decision to make a change.

Thirty-seven percent of fund managers review transactional law firms on a deal-by-deal basis, while 13% only initiate a review if an issue arises, and 30% have no plans to review or make a change (Fig. 13). Thirty percent of fund managers review placement agents when bringing a new fund to market, while 43% state they simply have not changed placement agents and do not plan to do so.

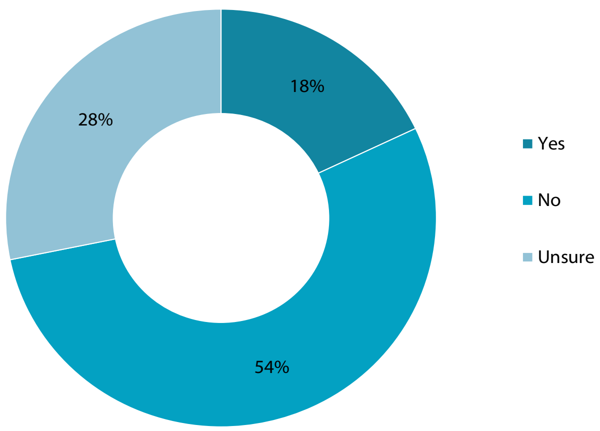
As seen in Fig. 13, only 18% of managers stated that their investors are concerned by the rising cost of third-party service providers. There are two sides to this story, as increased cost can affect the bottom line, but outsourcing of certain operations can also keep a fund manager concentrating on the most important parts of their business. Notably, the largest proportion (42%) of respondents are not looking to outsource any new functions in the next 12 months, followed by 17% that expect to outsource legal/compliance services (Fig. 14).

Fig. 12: Frequency with Which Venture Capital Fund Managers Review Service Providers



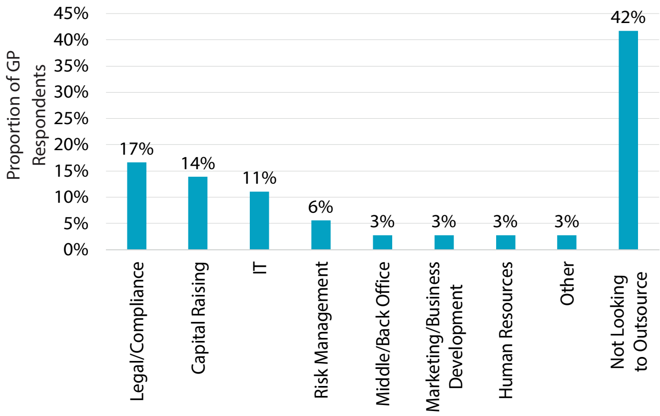
Source: Preqin Fund Manager Survey, June 2017

Fig. 13: Fund Manager Views on whether Investors Are Concerned About the Increased Cost of Third-Party Service Providers



Source: Preqin Fund Manager Survey, June 2017

Fig. 14: Business Areas which Fund Managers Expect to Outsource to a Third-Party Service Provider in the Next 12 Months



Source: Preqin Fund Manager Survey, June 2017

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