PREQIN SPECIAL REPORT:
UP & AWAY: LAUNCHING A FIRST-TIME VENTURE CAPITAL FUND

NOVEMBER 2017

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FOREWORD

Positive performance for venture capital funds in recent years has sparked attraction from investors, resulting in an increasing number of first-time and spin-off managers entering the industry.

Competition is high among managers: the venture capital fundraising market is home to over 1,500 vehicles seeking institutional capital. For less experienced managers, fundraising can be daunting – investing successfully in this crowded venture capital market relies on high levels of skill, extensive resources and strong networks. First-time managers may therefore be at a disadvantage in this competitive fundraising environment, so it is crucial that their time is efficiently spent targeting the right investors with plans and preferences that align with those of their fund.

While new or emerging managers may face additional challenges due to a lack of track record, Preqin's performance data shows that first-time and spin-off venture capital funds of vintage 2010 or older have generated substantially higher median returns than funds of experienced managers. Performance data can help make the case that first-time or spin-off funds could satisfy certain institutional portfolios that account for higher levels of perceived risk, as well as help managers to verify a record of successful performance in previous private capital roles.

Is gaining institutional support realistic with so many managers on the road? How can these less experienced managers build successful relationships with new investors? What tools can first-time managers utilize to help raise capital efficiently and, more importantly, successfully?

Despite the various challenges faced by first-time and spin-off managers, success is more than possible given the appropriate tools and approach to institutional investors. In this report, we examine the recent successes of first-time venture capital managers and use Preqin data to uncover some of the key factors managers should consider when raising institutional capital for the first time.

We hope that 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.

CONQUERING THE LACK OF TRACK RECORD

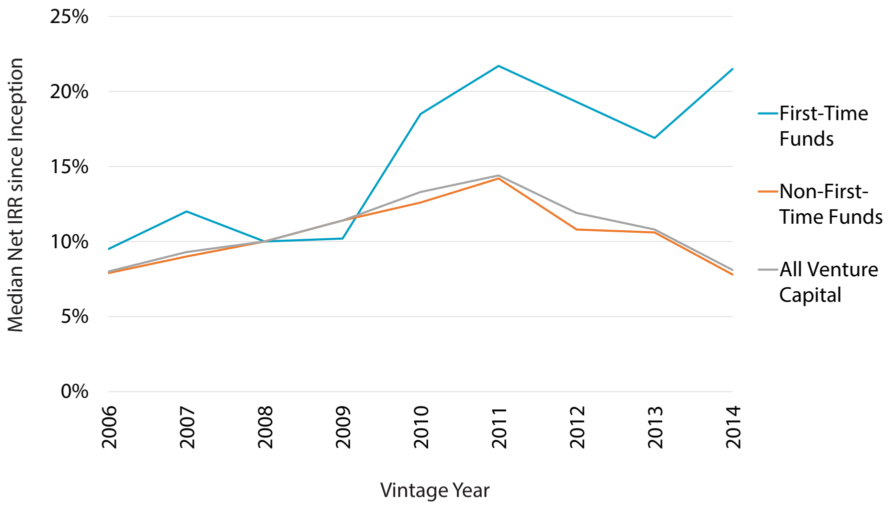
As at September 2017, there are more than 590 first-time or spin-off venture capital fund managers raising capital worldwide; up from 470 this time last year, it is clear that competition is growing among less experienced firms. Nonetheless, these managers are also competing for institutional capital against more than 900 experienced managers in the global venture capital market.

Typically, managers without a track record face more obstacles when fundraising than more experienced managers; however, when comparing the returns generated by 2006-2014 vintage venture capital funds, first-time managers generally outperform the pool of experienced venture capital managers (Fig. 1). The median net IRR for 2006-2014 vintage first-time venture capital funds (+12.9%) sits a full three percentage points higher than that of experienced managers (+9.9%), with risk levels (measured by standard deviation of net IRR) at 19.1% and 15.6% respectively. The higher return profile has not come without greater risk: Fig. 2 illustrates the higher standard deviation generated by inexperienced managers.

> ***First-time managers outperformed experienced managers for 2006-2014 vintage venture capital funds***

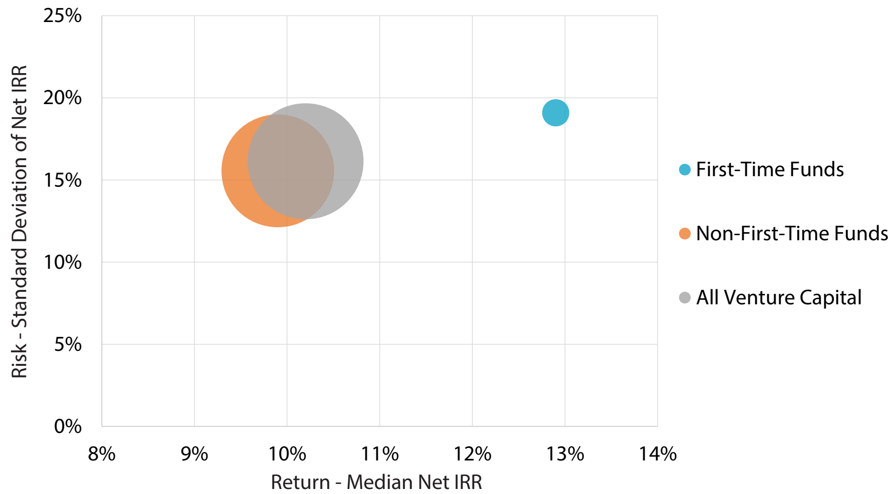
Investors with less restrictive investment criteria and rules, such as family offices, and a high level of confidence in their selection ability may be willing to take on this added risk in order to expose themselves to potential higher returns. More experienced investors with bigger programs are often able to combine their selection expertise with a large enough portfolio to achieve diversification and overcome the potential dangers of investing with a small number of untested managers, despite typically more restrictive investment criteria.

Fig. 1: Median Net IRRs of Venture Capital Funds by Vintage Year



Source: Preqin Venture Capital Online

Fig. 2: Risk/Return Profile of Venture Capital Funds (Vintages 2006-2014)



Source: Preqin Venture Capital Online

Where a track record for a new entity is not available, it is helpful to demonstrate the past performance of managers while at former roles, managing venture or private capital. Citing verifiable net-to-LP returns, including the IRR for previously managed vehicles and multiples achieved for prior investments, and referencing the deals in which the new manager acted as lead partner or assumed a board position, will help to build credibility with LPs in lieu of a traditional track record.

With the majority of first-time fund managers raising relatively small vehicles, it may be useful to highlight the potential advantages that smaller funds can bring as well as the opportunities unique to micro venture capital. Managers that achieve success are often those that can communicate the virtues of both their fund and the smaller first-time fund landscape, rather than simply presenting themselves as the potential superstar brand name of the future.

APPROACHING INVESTORS: WHERE TO START

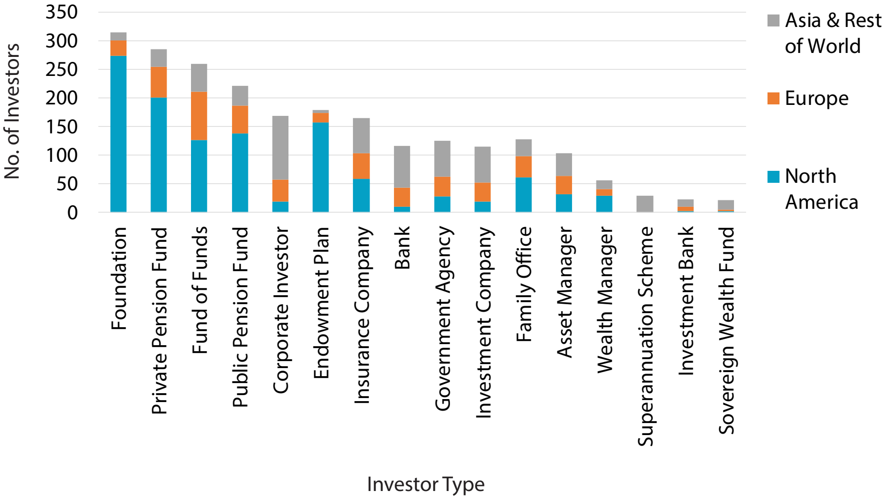
Preqin's **Venture Capital Online** tracks over 4,400 global investors actively targeting or considering investing in venture capital. More than half of those investors have either committed to first-time managers previously, or are open to making commitments in the future. Knowing who and where to target can save time as well as money, which is crucial in such a competitive environment. Time wasted chasing dead-ends, such as investors with explicit policies to not invest in firms without a track record, could be spent forming relationships with those that are actively seeking new managers.

Preqin can be a useful tool for first-time managers throughout the entire fundraising cycle by helping to identify the best prospects. Historically, North America-based investors have been the most active in first-time and spin-off funds; 1,159 North America-based investors are known to have participated in such funds, more than Asia (646) and Europe (507) combined.

Foundations are the most active investor type in first-time or spin-off venture capital funds, with those based in North America accounting for 79% of all foundations active in these funds (Fig. 3). The second most active investor type is private sector pension funds, of which the largest proportion (70%) is also based in North America. Some of the largest foundations and pension funds seek out first-time managers through their emerging manager programs, such as W.K. Kellogg Foundation or New York State Common Retirement Fund.

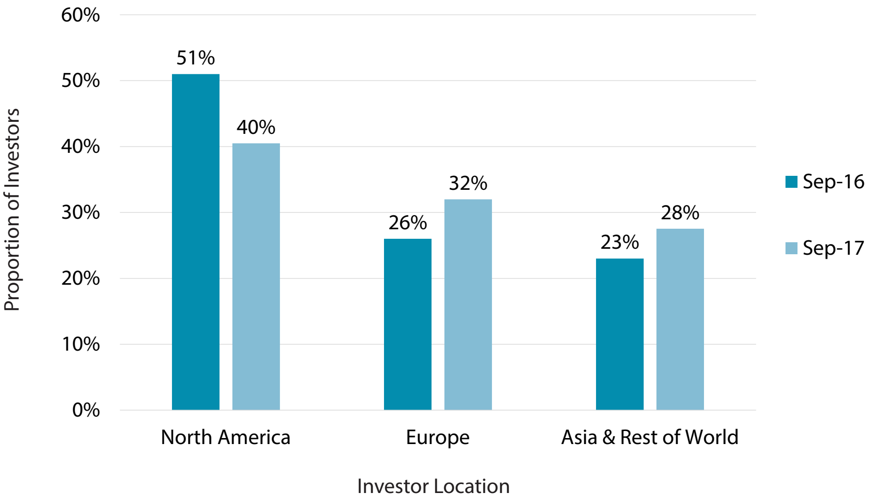
While North America-based investors account for the largest proportion (40%) of investors with active first-time or spin-off mandates, this has declined from 51% in September 2016 (Fig. 4). Contrastingly, a greater proportion of both Europe- and Asia-based investors are actively seeking first-time or spin-off funds than this time last year, having increased by six and five percentage points respectively.

Fig. 3: Venture Capital Investors with Active Mandates for and/or Past Investments in First-Time Funds by Type and Location (As at September 2017)



Source: Preqin Venture Capital Online

Fig. 4: Venture Capital Investors with Active First-Time or Spin-off Mandates by Investor Location, 2016 vs. 2017



Source: Preqin Venture Capital Online

FUND SEARCHES AND MANDATES

Subscribers to **Venture Capital Online** can click **here** to view detailed profiles of 727 institutional investors in venture capital actively searching for new investments over the next 12 months with the **Fund Searches and Mandates** feature.

Preqin tracks the future investment plans of investors in venture capital, allowing subscribers to source investors actively seeking to invest capital.

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PRE-LAUNCH CONSIDERATIONS

While it is encouraging news that over half of the 4,400 active venture capital investors Preqin tracks do consider first-time or spin-off funds, the question remains for new managers: where do I start?

Identifying investors that may be a good fit for a fund based on past investment activity, preferences and future mandates is one of the primary qualifiers in any fundraising process, and there are some simple first steps that we suggest before hitting the road.

LOCATION

Refining searches by investor geographic preferences can reveal opportunities with local investors that have mandates for venture capital funds focused on investments in their home region. Managers should seek LPs that have a remit for local development; for example, government agencies Government of Ontario and Oregon Growth Board recently made commitments to Scale Up Ventures Fund and Seven Peaks Venture Fund I respectively, which are first-time venture capital vehicles that focus on local development.

PREVIOUS INVESTMENTS

Managers targeting investors that have committed to vehicles like their own may have more success. Preqin tracks over 375 first-time venture capital funds that have held interim or final closes since the beginning of the year (as at September 2017), with many of the investors that are known to have committed to these vehicles still actively seeking out new opportunities.

Guardian Life Insurance, for example, recently committed to Advantech Capital, a first-time growth vehicle targeting investments in the TMT, e-services, and healthcare sectors in China. The commitment is one of the 12-15 private equity investments the insurance company has planned for 2017.

SOCIAL IMPACT AND ESG FACTORS

Does your fund have a focus on social impact/ESG factors? Managers raising funds with a social impact ethos can narrow their investor search accordingly. Investors such as Ford Foundation and TIAA are targeting impact funds which seek to deploy capital in minority-owned, women-owned, environmentally friendly and socially responsible portfolio companies.

FUNDS OF FUNDS

A departure from the traditional LP-GP format, many funds of funds are highly active in the venture capital industry. Often looking to capitalize on first-time fund upside potential, more than 250 fund of funds managers across 34 countries are considering or investing in first-time venture capital managers. IIFL Private Wealth Management, for instance, has recently committed to Iron Pillar's maiden India-focused vehicle, Iron Pillar Fund I, via its fund of funds vehicle, IIFL Seed Ventures Fund I.

FIRST-TIME FUNDS ON VENTURE CAPITAL ONLINE

26%
of investors using Preqin's **Venture Capital Online** have local mandates.

1,800+
investors are known to have committed to first-time venture capital funds.

250
funds of funds are considering or have already invested in first-time venture capital funds.

TIPS AND TRICKS FOR FUNDRAISING

CONTACT PREFERENCES

Once promising leads are identified, contacting the potential investor directly through the proper channels could mean the difference between securing a commitment and not getting past voicemail. Whether contacting them directly or through a consultant, it is essential to be armed with the up-to-date preferred methods of contacting investors. Some institutional investors employ consultants that screen all incoming proposals, certain investors utilize a single general consultant, while others have several asset class-specialized consultants. Cambridge Associates, for example, serves as the general consultant to Maine Public Employees' Retirement System, University of Michigan Endowment and Charles Stewart Mott Foundation. Employees' Retirement System of Texas and Maryland State Retirement and Pension System both utilize asset class specialist Altius Associates, for its expertise in private equity and venture capital.

CORNERSTONE INVESTORS

Securing one or more cornerstone investors (reputable investors making substantial early commitments) lends inexperienced managers considerable credibility among other investors, and can go a long way towards fundraising success. As time is of the essence for fundraising managers, starting conversations with influential investors early is key to gaining momentum as quickly as possible.

> ***750 investors are interested in first-time venture capital funds and first-close commitments***

Managers can identify potential cornerstone investors by seeking investors open to making commitments to funds that meet their preference criteria prior to the first close, as well as reviewing the market to establish which investors have recently committed to a first-time fund ahead of its first close. Preqin **Venture Capital Online** tracks over 750 investors that invest in first-time and spin-off funds and consider investing in a fund before its initial close.

Questa Capital Partners I and Karma Ventures I have both been successful in securing cornerstone investors within the past six months. San Francisco-based Questa Capital Partners secured almost half ($100mn) of its $250mn target at the first close, including a $50mn commitment from University of Texas Investment Management Company; and Karma Ventures received cornerstone investments from European Investment Fund, LHV Asset Management and Ambient Sound Investments for its early stage debut fund, surpassing its initial target of $55mn by the second close (Fig. 5).

INVESTORS OPEN TO FIRST-TIME VENTURE CAPITAL FUNDS

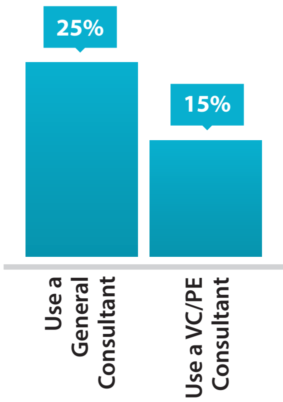


Fig. 5: Sample Cornerstone Investors in First-Time Venture Capital Funds, 2017 YTD (As at September 2017)

Fund	Firm	Target Size ($mn)	Fund Status	Cornerstone Investor(s)
Karma Ventures I	Karma Ventures	55	Second Close	European Investment Fund, LHV Asset Management, Ambient Sound Investments
Anthemis Venture Fund I	Anthemis Group	100	Second Close	UniCredit Group, European Investment Fund, IMI Fondi Chiusi
Questa Capital Partners I	Questa Capital Management	250	First Close	University of Texas Investment Management Company
Dymon Asia Ventures	Dymon Asia Ventures	50	Second Close	Digital Ventures, Siam Commercial Bank
Fireside Ventures Fund I	Fireside Ventures	47	First Close	Premji Invest, Sharrp Ventures

Source: Preqin Venture Capital Online

Fig. 6: Sample Custom Benchmark: Asia-Focused First-Time Venture Capital Funds Targeting Telecoms, Media & Communications (Vintages 2004-2014)

Benchmark	Called up (%)	Distributed (%) DPI	Remaining Value (%) - RVPI	Net Multiple (X)	Net IRR (%)
Median	97.1	57.2	104.2	1.59	12.2
Weighted	95.1	71.7	115.3	1.87	14.5
Average (Mean)	89.4	86.2	107.1	1.93	20.3
Standard Deviation	15.7	122.2	96.2	1.70	21.4

Source: Preqin Venture Capital Online

> *"Custom benchmarks can be used to spark a potential LP's interest by demonstrating strong past performance in a given industry or region*

BENCHMARK PERFORMANCE

Using Preqin's venture capital performance data, custom benchmarks can be created to provide context by tracking the historical performance of similar funds that have invested in a given industry or region. Custom benchmarks can be used to spark a potential LP's interest in an industry-specific fund: they can demonstrate that, despite limited exposure, the industry has great potential and a strong track record by creating a benchmark to mirror the average performance of similar funds by industry and/or geographic focus. This data-driven approach could lend a strong argument to a manager looking to capitalize on an industry or region's strong track record and potential for success in future. For instance, Fig. 6 shows a custom benchmark for Asia-focused first time venture capital funds targeting telecoms, media & communications of vintages 2004-2014. The benchmark was created with funds sized $500mn and under, a typical range for first-time vehicles, and reveals an average net IRR of over 20%.

DEAL SOURCING

Preqin's **Venture Capital Online** tracks over 125,000 venture capital transactions, including co-investments, exits, IPO pipelines and more. First-time fund managers can utilize this data to evaluate the market, discover trends and pinpoint future opportunities for their funds. They can also keep tabs on their peers, and view investments made by fellow first-time and spin-off funds. Through reviewing the activity of peers, managers can gain a better perspective of the potential deals that can be sourced for their funds, which can provide further context and encouragement to prospective LPs. A significant amount of first-time funds have sourced deals which turned into unicorns and household names, such as Softbank China Venture Capital Fund I's early pre-Series A investment in Alibaba Group.

Fig. 7: Sample Deals Invested in by First-Time Venture Capital Funds, 2017 YTD (As at September 2017)

Fund	Portfolio Company	Deal Size ($mn)	Stage	Location	Industry
Stellaris Fund I	930 Technologies Private Limited	1	Seed	India	Internet
Elephant Partners I	A Cloud Guru Ltd.	7	Series A/Round 1	UK	Other IT
Urban Innovation Fund I	APANA, Inc.	4	Series A/Round 1	US	Software & Related
Medicxi Ventures I	ApcinteX Limited	18	Series A/Round 1	UK	Healthcare
Target Global Early Stage Fund I	Auto1 Group GmbH	83	Series E/Round 5	Germany	Internet
Phyto Partners I, Salveo Fund I	Wurk	2	Seed	US	Software & Related
Las Olas VC I	Wine Plum, Inc.	9	Series A/Round 1	US	Other IT
Huasheng Capital Fund I	Beijing Yixiao Technology Development Co., Ltd.	350	Series D/Round 4	UK	Telecoms
Section 32 Fund I	Auris Surgical Robotics Inc.	280	Series D/Round 4	US	Software & Related
Seaya Ventures Fund	Maxi Mobility Spain, SL	100	Series D/Round 4	US	Software & Related

Source: Preqin Venture Capital Online

Fig. 8: Sample Unicorns Invested in by First-Time Venture Capital Funds, 2000-2016

Fund	Unicorn	Deal Size ($mn)	Stage	Deal Date	Industry
Softbank China Venture Capital Fund I	Alibaba Group	20	Unspecified Round	Oct-00	Internet
Autotech Fund I	Lyft, Inc.	752	Series F/Round 6	Jan-16	Telecoms
DST Global I	Facebook, Inc.	200	Series D/Round 4	Dec-10	Internet
Capital Today China Growth Fund	JD.com	10	Series A/Round 1	Aug-07	Internet
Valar Ventures Fund	Legend Pictures, LLC	128	Unspecified Round	Apr-12	Telecoms
Baseline Ventures Growth Fund	Social Finance	4	Series A/Round 1	Sept-11	Business Services
Beijing Jingguofa Equity Investment Fund I	Ready-Go	452	Series A/Round 1	Aug-16	Internet

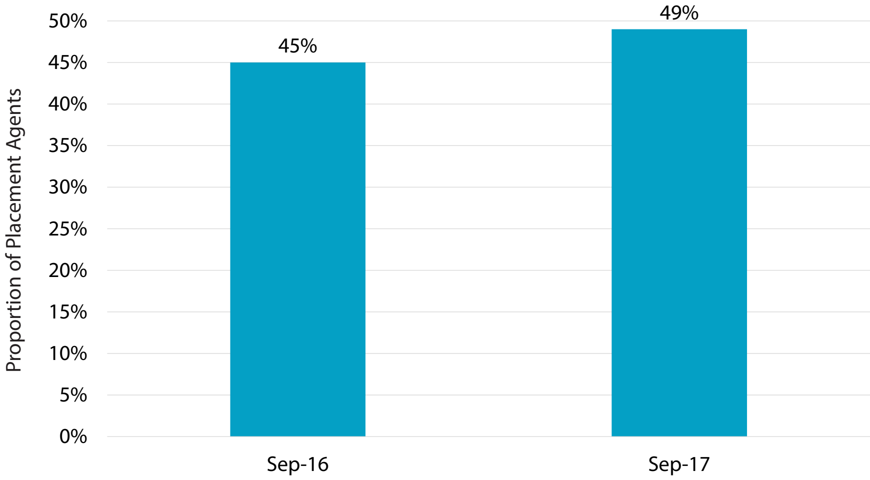
Source: Preqin Venture Capital Online

PLACEMENT AGENTS?

Among the many questions facing first-time managers when raising capital is whether to use a placement agent. As well as assisting managers in many aspects of fundraising, they will primarily tap into their extensive networks to deliver potential investors and add credibility to new managers. Placement agents can also help to create marketing materials, which adds value to the overall expenditure. There are 263 placement agents active within venture capital, of which 49% will work with first-time and spin-off fund managers, compared to 45% in September 2016.

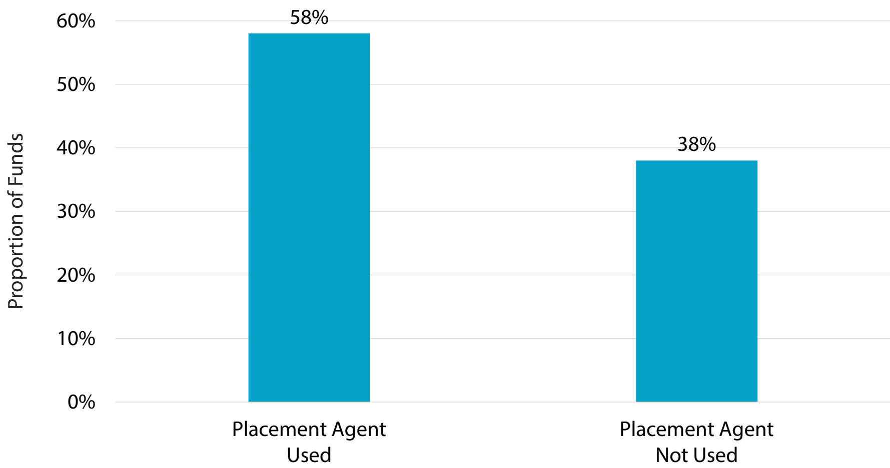
> ***Placement agents can utilize their extensive networks to deliver potential investors and provide added credibility to new managers***

Fig. 9: Placement Agents that Work with First-Time Venture Capital Fund Managers, 2016 vs. 2017



Source: Preqin Venture Capital Online

Fig. 10: First-Time Venture Capital Funds in Market that Have Held at Least a First Close by Placement Agent Use



Source: Preqin Venture Capital Online

With **Venture Capital Online**, managers can conduct research and due diligence on service providers across a wide range of criteria, including fund type expertise, geographic focus, fund size and more. Utilizing these criteria, along with the ability to easily filter by total number and value of funds closed and currently raising, managers can find a placement agent to best meet their needs. For example, one of four known funds currently being raised by Fern Creek Ventures is Stellaris Fund I, which has secured $50mn of its $100mn target for early stage investments in Asian start-ups. Fern Creek has previously helped to close at least one other early stage first-time venture capital fund and at least one Asia-focused general venture capital fund since 2016.

Thirty-six first-time managers currently raising venture capital funds have disclosed to Preqin that they are working with placement agents: just over 58% of these funds have held at least a first close, compared to 38% of first-time venture capital funds that are not using a placement agent. Health Velocity Capital I, the debut fund from Health Velocity Capital, has successfully raised $76mn of its $150mn target by its first close with placement agent Sparring Partners.

While the fees charged by placement agents can be significant (up to 3% is not unheard of for a first-time fund), the value of the time saved and potential for an on-target close can make this a worthwhile investment. Many of Preqin's clients choose to employ a hybrid approach, such as seeking the services of a placement agent in less familiar regions while conducting their own fundraising process for allocators closer to home.

SUCCESS IS POSSIBLE!

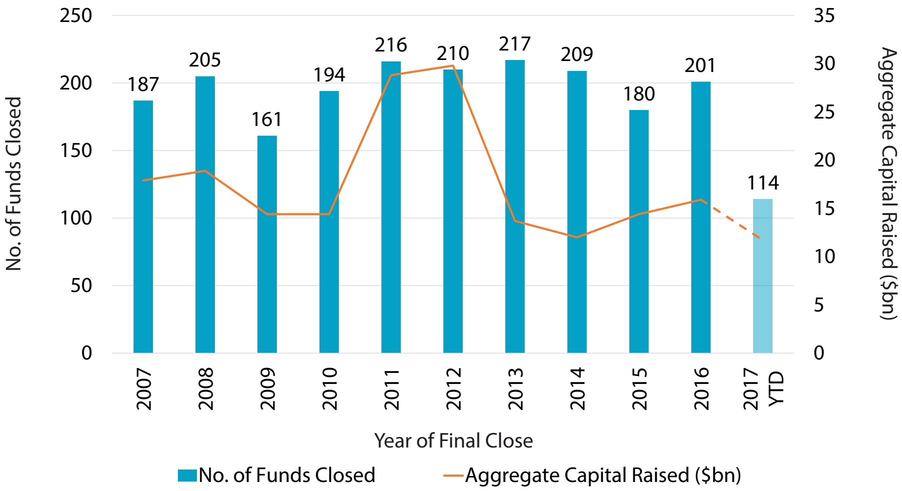
Over 31% (114) of the venture capital funds that have reached a final close this year have been first-time funds, compared to 25% in the same period last year. The final sizes of first-time funds closed this year range from a high of $1.5bn, secured by Mubadala Capital Fund I, to much smaller funds of $1mn, as secured by Cannonball Secrets. Over the past five years (2012-2016), an average of 203 first-time funds have raised an aggregate $17bn per year.

> ***First-time fund managers should start as early as possible, strategically identifying the best prospects and capitalizing on all available data and resources***

There are 594 first-time or spin-off venture capital funds in market (as at September 2017), seeking a total of $83bn in capital. Of these, over a third (38%) have held at least a first close, including Yissum's Agrinnovation fund, managed by Target Global, which secured $4mn of its $6mn target from investors including Australia-based single-family office Victor Smorgon Group.

While this is encouraging news, the fact remains that the fundraising market is extremely crowded, and many managers currently in market will struggle to achieve success in the face of such intense competitive noise. Fundraising can be lengthy, and time is the manager's most precious commodity of all. First-time fund managers should start their process as early as possible, strategically identify the best prospects, and capitalize on all available data and resources to form partnerships in the most intelligent way. The sooner that fundraising success can be achieved, the sooner the real work can begin…

Fig. 11: Annual First-Time Venture Capital Fundraising, 2007 - 2017 YTD (As at September 2017)



Source: Preqin Venture Capital Online

Fig. 12: Sample First-Time Venture Capital Funds Closed in the Past 12 Months (As at September 2017)

Fund	Firm	Type	Fund Size ($mn)	Final Close Date	Known Investor(s)
Mubadala Capital Fund I	Mubadala Capital	Venture Capital (All Stages)	1,500	Mar-17	Ardian
Asia-Germany Industrial Promotion Capital Fund I	AGIC Capital	Growth	1,000	Dec-16	China Investment Corporation
Asia Climate Partners	Asia Climate Partners	Growth	447	May-17	Asian Development Bank, ORIX Corporation, Department for International Development
Centana Growth Partners Fund I	Centana Growth Partners	Growth	296	Jun-17	Los Angeles Fire and Police Pension System, American Family Insurance, Baltimore Fire & Police Employees' Retirement System
Taxim Capital Partners I	Taxim Capital	Growth	223	May-17	International Finance Corporation, European Bank for Reconstruction and Development
Daphni Purple	Daphni	Early Stage	165	Oct-16	BPIFrance, Nokia, MAIF, Swen Capital Partners, PRO BTP
Ezdehar Egypt Mid-Cap Fund	Ezdehar Management	Growth	100	May-17	European Bank for Reconstruction and Development, CDC Group

Source: Preqin Venture Capital Online

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