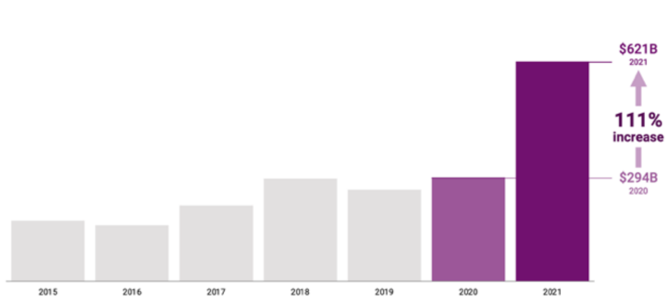
VENTURE CAPITAL - FLASH UPDATE

STATE OF VC IN 2021

2021 was a record year for Venture Capital. Receptive public markets drove increased investments in all stages of VC and 2021 saw ~$330b invested in VC (in the US, which is a good proxy for the whole world), almost double the 2020 numbers ($167b). The increase was both on the number of deals as well as the investment per deal. And VC investing, which was previously almost exclusive to funds, saw many newcomers in the form of family offices, PE funds and hedge funds investing in the asset class. New funds were formed and the amount of funding available to the industry globally more than doubled in the year.

This new influx of money available was met by an increased supply of companies trying to disrupt every sliver of every industry leveraging technology. We heard from virtually all of the GPs we've met that in 2021 there was a notable improvement in the quality of the teams running startups; becoming an entrepreneur or working for a startup was in 2021 the preferred career choice for many young professionals that were delighted by the prospects of fame & fortune. However, this increased supply of startups was clearly not enough to accommodate the increased demand, and as a result the valuations increased across the board – the series A deal heuristics of earlier years were in 2021 used for seed rounds, we saw companies jumping from seed to series B, and other excesses that reflects that the industry did not knew how to deal with the excess money it attracted.

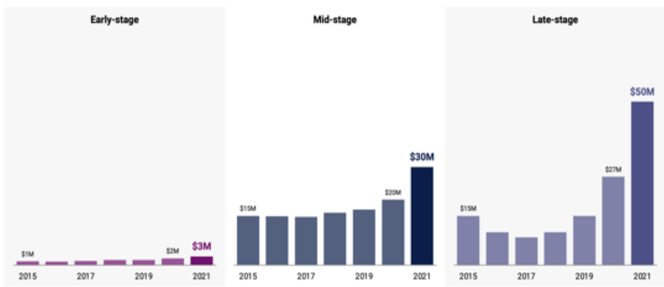
Global funding increases 111% YoY to reach $621B



Source: The State of Venture (CB Insights)

In 2021, the macro-economic environment and the lack of higher yield investment alternatives led to very large funds raised by the likes of Tiger and Softbank. To accommodate this influx, they deployed capital at an unprecedented pace, on unprecedented terms – very high valuations and minimum rights or governance. Many companies, including some from our portfolio, worried about the duration of the pandemic benefited from this and filled their coffers with cash at favorable terms. Those high valuations became the "new normal" – and paying 100x sales for a company that was losing money became acceptable within many respectable investors.

Median deal size is up for all stages — nearly double for late-stage deals



Source: Pitchbook Venture Monitor Q4/21

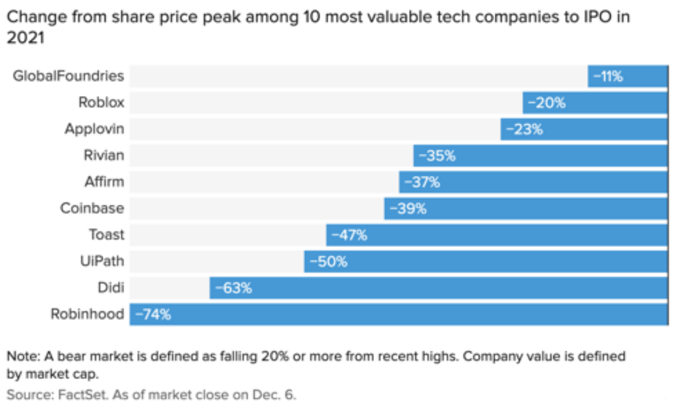
While those trends happened across the globe, many regions and many sectors have had their own idiosyncrasies.

Europe saw in 2021 the renaissance of Venture Capital. For an innovation ecosystem to thrive, it needs a critical mass of entrepreneurs, investors and market acceptance of technology solutions. In 2021, we witnessed a sharp increase in the number of unicorns (which translates into both happy investors and wealthy entrepreneurs and early executives, who invest part of their fortunes back into the ecosystem), many interesting new fund and fund managers and many US investors setting up European headquarters. We've invested significant resources in mapping the European ecosystem.

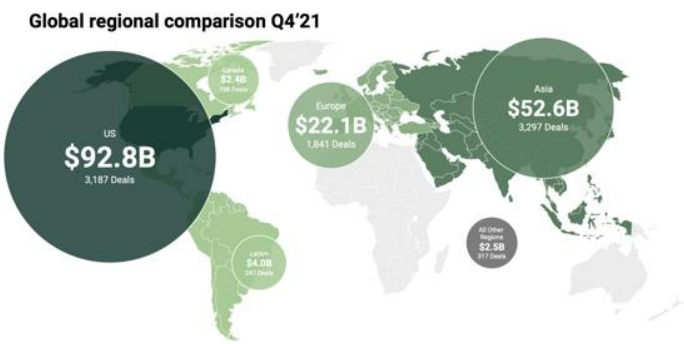
China sent some mixed signals to the VC market. While the VC ecosystem continued to be very dynamic, the government surprised everyone by regulating certain sectors and casting a shadow of doubt on what it would do next. It prevented Chinese fintech giant Ant financial to IPO, but also banned for-profit tutoring and stopped short of banning videogames (banning console and restricting video-game usage for minors). We understood from our Chinese GPs at Cathay the rationale for those movements (in a country that wants to be seen as the champion for equality of opportunities, for-profit tutoring – that benefits the pupils of the rich - have no place). But the uncertainty that those moves are enormous and makes the question of 'where the government will interfere next' very hard to answer. We mapped the Chinese fund ecosystem and went on to execute due-diligence in a few top tier 1 funds, but ultimately decided to limit our exposure to the region.

Crypto VC funds detaches from traditional VC houses. Many mainstream VC fund managers have included crypto investments in their portfolios. However, most of those houses have not really embraced crypto and virtually all of their investments are in crypto "infrastructure" – or the pillars that would support a crypto economy. Those are least risky crypto investments and reflect, in our opinion, the lack of understanding of crypto by most of those managers – an assessment that was reinforced by tens of interviews we made with them. On the other hand, many crypto-only funds popped up in every geography, and the first vintages of those funds have been performing very well. It is an area where we are spending more time and resources.

Public markets love for tech was also quite volatile in 2021. The year started with a record number of companies going public – via traditional IPOs or via SPACs – and ended with market multiples for tech companies deteriorating and a complete freeze on IPOs. Many of the companies that IPO'd during the year lost relevant value during the year. Changes in macro-economic conditions certainly impacted public markets appetite for tech stocks.



We saw large volumes of activities in VC in many ecosystems across the globe but the US still leads as the most active place for the industry. Europe and Asia continue to grow. Latin America represents 2.5% of the global VC industry.



Source: Crunchbase Global Venture Funding 2021

WHAT TO EXPECT IN 2022

In 2022, we are already seeing a different mood in Venture Capital than what we've seen over the previous 2 years since the inception of the fund (but not different than other VC 'winters' – the industry is cyclical). Megarounds at outrageous valuations ceased to exist, and fund managers have been warning their portfolio companies to manage cash as if it were a scarce resource, and not like it has been over the previous years.

Most of the companies that went public in the last years are not performing well, which effectively closes the public markets for new companies, and put pressure on private valuations – why would an investor pay higher multiples for a private company than for a company that is growing as much as the private one and is already public?

Many fund managers don't have experience in operating in this new environment. As legendary investor Bill Gurley (one of the founders of Benchmark, a tier 1 early stage fund) wrote earlier this year, "… an entire generation of entrepreneurs & tech investors built their entire perspectives on valuation during the second half of a 13-year amazing bull market run. The 'unlearning' process could be painful, surprising and unsettling to many…" We believe we chose fund managers that can thrive on the challenges of the time ahead, and will continue to monitor and work closely with them. Specifically, we believe that they should work with their portfolios on the following topics:

Cash: continuously educate and monitor their portfolio companies about cash discipline. Cash runway and reducing burn are key to live in the coming uncertain months. Companies with unfavorable unit economics will have a challenge raising additional rounds and should focus on adjusting them in lieu of growth.

Liquidity: we believe liquidity events will be scarce in the next 6-12 months; IPO and SPAC window are effectively closed, and companies should not rely on such events on their short-term plans.

Human Resources: with potential down rounds in the horizon, the value of stock-based compensation will likely erode, and as such, employee morale might suffer.

M&A: with more companies failing, there will surely be opportunities for acquisitions for both market share, technology and talent. Companies (in growth stages) should consider looking for those possibilities.

While the stream of news from the public markets and from the press are certainly depressing, it is not the first time that we've seen corrections in the VC market, and we learned that in scenarios like this, opportunities to create value arise. We believe that there will be plenty of opportunities to invest in companies at adjusted valuations that could appreciate significantly. Also, we believe there will be opportunities in the secondary markets both for LP interests, as well for direct investments in companies, and we plan to be alert to those opportunities.